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IN THE UNITED STATES SUPREME COURT

OCTOBER TERM, 1984

WILLIAM F. BONNER, JR., ESTATE OF
BETTINA BONNER, WILLIAM F. BONNER, JR.,
EXECUTOR, TRANSFEREES,

PETITIONERS,

V.

COMMISSIONER OF INTERNAL REVENUE

# PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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179pp

## QUESTIONS PRESENTED

I. Does application of the excise tax provided in §4945 of the Internal Revenue Code of 1954 ("Code"), which deprives the petitioners of property rights vested in them in 1905, result in a denial of due process under the Fifth Amendment of the Constitution of the United States?

II. Were petitioners denied procedural due process under the Fifth Amendment of the Constitution of the United States when they were penalized as a result of the failure of the Board of Trustees of the John M. Bonner Memorial Home ("Board") to give timely notice of its intention to terminate its status as a private foundation under §507 of the Code prior to distributing its remaining assets to petitioners

when, under all the circumstances, it was not possible for the Board to determine the time and manner in which notice was required to be given?

## LIST OF PARTIES

The following additional parties are not listed in the caption:

William Kelly Gladney,
Evelyn Gladney Witherspoon,
Celeste Gladney Peers,
Julian M. Gladney, and
Edward Lee Gladney.

These additional persons were parties to consolidated suit No. 83-4229 in the Court of Appeals below and have indicated to Petitioners that they also intend to file a separate Petition for Certiorari before this Court.

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# IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1984

WILLIAM F. BONNER, JR., ESTATE OF
BETTINA BONNER, WILLIAM F. BONNER, JR.,
EXECUTOR, TRANSFEREES,

V.

COMMISSIONER OF INTERNAL REVENUE

---

# PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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The Petitioners, William F. Bonner, Jr. and the Estate of Bettina Bonner, William F. Bonner, Jr., Executor, respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered on November 5, 1984.

## OPINIONS BELOW

The text of the Opinion of the United States Court of Appeals for the Fifth Circuit, rendered November 5, 1984, reversing the decision of the United States Tax Court's judgment in favor of Petitioners and remanding the cause to the Tax Court, appears in Appendix B to this Petition, and is reported at 745 F.2d 955 (5th. Cir. 1984).

The Order of the United States Court of Appeals for the Fifth Circuit denying the Petition for Panel Rehearing and denying the Petition for Rehearing en banc, dated February 15, 1985, appears in Appendix D to this Petition.

The Memorandum Opinion of the United States Tax Court, rendered in favor of

Petitioners on December 6, 1982, appears in Appendix E of this Petition, is not reported in the Official Reports of the United States Tax Court but is published as T.C. Memo 1982-708, 45 TCM 280, ¶82,707 P-H Memo TC (1982).

## JURISDICTION

The judgment of the United States Court of Appeals for the Fifth Circuit (App. B, infra) was entered on November 5, 1984. A Petition for Panel Rehearing and Rehearing en banc was denied on February 15, 1985 (App. D, infra). The Jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## CONSTITUTIONAL AND STATUTORY PROVISIONS

This case involves the following constitutional and statutory provisions, the relevant portions of which are reproduced in Appendix A, infra:

United States Constitution:
Fifth Amendment

Internal Revenue Code of 1954 (26 U.S.C.): §§507(a), 507(c), 507(d), 4945(a), 4945(b), 4945(d), 6104(c)(1)(B), 6104(c)(2).

Louisiana Civil Code of 1870: Articles 490-492, 940-949, 1523, 1527, 1559, 1696-1699, 1704, 1709-1710, 2021, 2023, 2026, 2028-2030, 2045.

## STATEMENT OF THE CASE

A trust for the purpose of founding and maintaining a home for aged and infirm men was established and funded by a specific legacy under the terms of by the last will and testament of Lelia Bonner Dwyer who died on June 22, 1905, prior to the enactment of any applicable federal taxation legislation.

In accordance with the terms of the decedent's will and the then applicable provisions of Louisiana law, the Trustees for the Trust organized a charitable corporation known as the "Board of Trustees of the John M. Bonner Memorial Home" ("Board"). The Trust operated the Home until July 1, 1971, when it was closed because the cost of maintenance and operation

of the Home substantially exceeded all available revenues.

In 1970, the Internal Revenue Service ("IRS") sent the Board a form letter transmitting a Form 4653 (Notification Concerning Foundation Status) and instructions regarding status and classification as a private foundation pursuant to provisions of the Tax Reform Act of 1969. By letter dated August 21, 1970, the Board forwarded the completed Form 4653 to the IRS, stating that the Board was a private foundation within the meaning of §509(a) of the Internal Revenue Code ("Code"), and that it was an operating foundation within the meaning of §4942(j)(3).

On July 1, 1971, the Board closed the John M. Bonner Memorial Home.

A form letter dated July 9, 1971, was sent to the Board by the IRS, stating that the IRS was waiting for the promulgation of Treasury regulations pertaining to §509 before it would respond to the Form 4653 submitted by the Board. By form letter dated October 5, 1971, the Board was notified that it had been classified as a private foundation as defined in §509(a) of the Code and as an operating foundation as defined in §4942(j)(3).

On November 5, 1971, the Petitioners herein, together with other heirs of Mrs. Dwyer, filed a petition in the Louisiana Civil District Court for the Parish of Orleans, asking that the donation to the Trustees of the Trust be dissolved "on account of the non-performance of the condi-

tions imposed by the donor on the donee", and that they, as Mrs. Dwyer's heirs, be declared to be entitled to the remainder of the assets donated by Mrs. Dwyer. A judgment was rendered on December 23, 1971, ordering the John M. Bonner Memorial Home dissolved, since the Trust had been completely fulfilled and could not be further performed, and ordering the Trustees to deliver the property to Petitioners and the other heirs of Mrs. Dwyer.

Pursuant to the judgment of the Civil District Court, property was distributed to Petitioners on January 18, 1972, and March 13, 1972, prior to the promulgation of any regulations setting out the time and manner in which a private foundation must give notice of its termination or dissolution un-

der §507 of the Code. After these distributions of property, the Board was without further assets.

A Notice of Liquidation, Dissolution, and Termination (Form 966-E) dated October 24, 1973, was filed with the IRS on behalf of the Board, stating that the Board had been dissolved and that final distribution of assets had been made.

The Commissioner of Internal Revenue ("Commissioner") determined deficiencies against the Board for the reason that the distributions made to the Petitioners and the other heirs were "taxable expenditures" because they were made "for purposes other than expressed in section 170(c)(2)(B)," as provided in §4945. Additionally, the Commissioner determined transferee liabilities

under §4945 against the Petitioners and the other heirs equal to the full fair market value of the distributions to them.

Petitioners filed a timely petition with the United States Tax Court ("Tax Court"), seeking a redetermination of the deficiencies in the 10% excise tax under the provisions of Code §4945(a)(1), and in the 100% additional (penalty) tax under §4945(b)(1), and contesting the determination of transferee liability.

The cases were submitted fully stipulated, including the fact that there was no aggregate tax benefit as defined in §507(d) resulting from the Trust's tax exempt status.

On December 6, 1982, the Tax Court filed its Memorandum Opinion 1982-708, 45

TC Memo, 280, ¶82,707 P-H Memo TC (1982), holding that under the circumstances, the Board's private foundation status (if any) was terminated under §507(a) upon the entry of the Louisiana District Court judgment on December 23, 1971, and that the subsequent transfers of assets in accordance with the said Louisiana District Court judgment did not give rise to excise taxes under the provisions of Code §4945. Accordingly, Petitioners had no transferee liability. The Tax Court further concluded that under the state of the law and the factual situation at the end of 1971, the notification requirements were satisfied by subsequent filings by the Board stating that it had been dissolved, and that final distributions of assets had been made. The Court's

decision was entered December 8, 1982. Commissioner's motions for Full Court Review, a Reconsideration of Opinion, and to Vacate Decision were denied by the Tax Court.

Commissioner filed timely notice of appeal, and Petitioners filed timely notice of cross-appeal. The parties stipulated venue to the United States Court of Appeals for the Fifth Circuit. In oral argument before the Court of Appeals, the Commissioner conceded that if the Trustees had simply given prior notice of their intention to distribute the residual assets of the Trust in accordance with the judgment of the Louisiana District Court, there would have been no basis for any excise tax or additional penalty tax under the provi-

sions of §4945, as stated in the strong dissenting opinion of Circuit Judge Politz.

The United States Court of Appeals for the Fifth Circuit reversed and remanded the decision of the Tax Court, holding that Petitioners were liable for private foundation excise taxes due to the Board's failure to notify the IRS of the termination of its private foundation status prior to the distributions to the Petitioners and the other heirs, and that the application of the private foundation excise tax statute in this case did not violate due process.

The Court of Appeals additionally rejected Petitioners' contention that the Trust was a "split interest trust" eligible for exemption from private foundation excise taxes.

Petitioners' Suggestion of En Banc Consideration (also considered by the Fifth Circuit to be Petition for Panel Rehearing) was denied on February 15, 1985. Petitioners were granted a Stay of Issuance of Mandate to and including April 3, 1985, to allow for petition to this Honorable Court for a review on Writ of Certiorari.

## BASIS FOR FEDERAL JURISDICTION WITH THE UNITED STATES TAX COURT

The basis for federal jurisdiction in the United States Tax Court, the court of first instance, is 26 U.S.C. 6213.

## REASONS FOR GRANTING THE PETITION

### I.

The court below has decided an important constitutional question in a way not in accord with applicable decisions of this Court and applicable principles of constitutional law enunciated by this Court. In holding that the tax imposed by §4945 of the Internal Revenue Code ("Code") was constitutional as applied to Petitioners, the court below has deprived Petitioners of property rights vested in them some 64 years prior to enactment of the Code article. In so doing, the court below has committed unsupportable error and has brought about a fundamental denial of justice to these Petitioners.

It is evident that the law being applied by the Court of Appeals for the

Fifth Circuit is contrary to, rather than in accord with, the law as enunciated by this Court. Exercise of this Court's power of supervision would accordingly be called for even if the decision below affected only the rights and interests of these Petitioners alone.

The applicable constitutional standard concerning the retroactivity of taxing statutes was elaborated upon by this Court in Welch v. Henry, 305 U.S. 134, at 149 (1938), in which it was stated that:

> In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation. (Emphasis added.)

In relying on Fernandez v. Wiener, 326 U.S. 340 (1945), and United States v. Jacobs, 306 U.S. 363 (1939), the court be-

low misapplied the balancing test enunciated in Welch v. Henry, supra. It disregarded the first factor required to be considered by that test -- the nature of the tax.

In Fernandez and Jacobs, supra, this Court ruled on the constitutionality of taxes that were clearly revenue measures. Revenue raising purposes have long been considered of paramount importance when applying the balancing test of Welch v. Henry, supra. See, First National Bank in Dallas v. U.S., 420 F.2d 725 (Ct. Cl., 1970), cert. denied 398 U.S. 950 (1970); Purvis v. U.S., 501 F.2d 311 (9th Cir., 1974). The tax at issue in this case, however, is clearly an excise tax in the nature of a penalty. It is also confiscatory in nature, since its application would result in a tax equal to 100% of Petitioners'

inheritance. It is part of a regulatory scheme that was never designed to generate revenue, because if effective, no revenue would be raised. Where the taxing statute is not intended to raise governmental revenues, but rather is intended to impose a penalty, stricter constitutional scrutiny should be given to retroactive application of the tax in order to avoid harsh and oppressive results.

There are additional reasons why application of Fernandez and Jacobs, supra, is not appropriate to the instant case. Jacobs, supra, dealt with application of the federal estate tax to the whole value of property held by the decedent in joint tenancy with his wife, where the decedent had contributed the entire amount of consideration for the property, and where the joint tenancy was created prior to enact-

ment of the taxing provision. Fernandez, supra, dealt with the application of the federal estate tax to the whole value of community property owned by decedent and his wife upon decedent's death, where the community was established prior to enactment of the taxing statute. This Court found in those cases that there was a shifting of interest in property, which was appropriately taxable, occurring after enactment of the taxing statute.

In the present case, there was no shifting of interest in property occurring after enactment of the taxing statute. Lelia Bonner Dwyer, under the terms of her will, established a trust for the John M. Bonner Memorial Home ("Trust") by a donation *mortis causa*, subject to the implied resolutory condition that at such time as her specific charitable intents and pur-

poses could no longer be performed by the Trustees, the donation to the Trust would be dissolved and any remaining properties distributed to her heirs at law. Under Articles 943 and 944 of the Louisiana Civil Code of 1870, a legal heir receives all rights and advantages of the decedent from the instant of death. The Petitioners acquired property rights that arose and vested at the moment of the decedent's death in 1905, under the decedent's will and Louisiana laws of successions and donations. The later distributions by the Trustees pursuant to the order of the Civil District Court merely constituted a placing of the Petitioners in possession of their previously vested interest, not a shifting of interest from the Trust to the Petitioners.

Furthermore, the tax in Fernandez, supra, was not assessed against the surviving spouse's property to pay the tax on the decedent's estate. The value of the property belonging to the surviving spouse was included for the purpose of calculating the tax due by the estate of the decedent, but there was no taking, by taxation, of the property interest that had shifted to the surviving spouse. In the present case, however, assessment of the tax will deprive Petitioners of their entire interest in property which was fully vested in them by inheritance approximately 64 years before enactment of §4945 of the Code.

The courts have recognized their obligation to construe retroactive application of statutes narrowly to avoid harsh and oppressive results.

> There is an element of fiction about a retroactive statute which particularly justifies an interpretation which will avoid unfair and unintended consequences. Kress v. U.S., 159 F.Supp. 338 (Ct. Cl., 1958).

In Blodgett v. Holden, 275 U.S. 142 (1927), and Untermyer v. Anderson, 276 U.S. 440 (1928), this Court held unconstitutional the retroactive application of taxing statutes that purported to impose a tax on transactions consummated prior to enactment of the statutes. These cases are similar to the one presently before this Court in that §4945 of the Code purports retroactively to apply a tax on a transaction (the donation mortis causa by Mrs. Dwyer) that was consummated some 64 years prior to the enactment of §4945.

This Court pointed out, in Blodgett, supra, at 147, that:

> It seems wholly unreasonable that one who, in entire good faith and

> without slightest premonition of such consequence, made absolute disposition of his property by gifts should thereafter be required to pay a charge for so doing.

The Court stated in Untermyer, supra, at 445 and 446, that "The taxpayer may justly demand to know when and how he becomes liable for taxes...."

In each of these cases, this Court held that taxing provisions, insofar as they undertook to impose a tax on gifts fully consummated before the provisions went before Congress (Blodgett, supra), or before their passage into law (Untermyer, supra), were arbitrary and repugnant to the due process clause of the Fifth Amendment.

It was the intention of Mrs. Dwyer that these Petitioners, her heirs, enjoy the property remaining upon occurrence of the condition dissolving the donation to the John M. Bonner Memorial Home. At the

time she wrote her will and at the time of her death, no applicable federal taxation legislation of any kind was in existence or under consideration. The parties affected, Mrs. Dwyer and her heirs, cannot have contemplated or had reasonable notice that provisions, the effect of which would be to deny the petitioners their inheritance, might be enacted in the future. To apply §4945 of the Code under these circumstances would be so harsh and oppressive as to violate the due process clause of the Fifth Amendment.

Furthermore, there is not a single counterbalancing governmental purpose sufficient to justify retroactive application of §4945 under these facts. This penalty, according to the legislative history of the private foundation provisions of the Tax Reform Act of 1969, was enacted to prevent

the use of such organizations to pass through the benefits of a tax-free accumulation of income, either directly or indirectly, to the grantors or managers of such funds.

In this case, there was no tax benefit received by Mrs. Dwyer or Petitioners as a result of the formation or operation of the Trust. At the time the property was distributed from Mrs. Dwyer's estate, the federal estate tax was not in effect, and so there was no advantage to be obtained from a charitable deduction. Additionally, the parties in this case have stipulated that, because of the nature of the investments held by the Trust and because of the operating losses incurred by the Trust, there was no aggregate tax benefit due as defined in §507(d) of the Code. This demonstrates that all of the income from the assets of

the trust was expended for its charitable purpose, and that no tax advantage whatsoever was obtained from the dedication of these assets to the charitable purpose of the Trust.

Accordingly, the Government has not been prejudiced in any way by the dissolution of the Trust and the placing of Petitioners in possesssion of their previously vested property interest. To impose the tax provided in §4945 of the Code retroactively under these circumstances would be not only harsh and oppressive, but also so arbitrary and capricious as to amount to a confiscation and offend the Fifth Amendment, pursuant to the principles laid down by this Court in Blodgett and Untermyer, supra.

## II.

The effect of the Government's actions in this case resulting in the confiscation of Petitioners' property was so arbitrary and capricious, and so violative of standards of fundamental fairness as to be unconstitutional.

The provisions of the Tax Reform Act of 1969, §§ 4945 and 507, were part of a statutory scheme to regulate charitable foundations and to eliminate abuses perceived by Congress in the operation of charitable foundations. The statutory scheme created the concept of private foundations and, through a complex series of rules and regulations, subjected such private foundations to the regulation of their operations, distributions and terminations. The Commissioner has taken the position that the liquidation of the Bonner

Memorial Home (the "Trust"), pursuant to the final order of Louisiana District Court on December 23, 1971, constituted a taxable expenditure under the provisions of §4945, under the catch-all phrase "for any purpose other than one specified in §170(c)(2)(B)". The Commissioner further contends that this court ordered distribution could not constitute a termination of a private foundation pursuant to §507 of the Code since the appropriate notice to the Internal Revenue Service was not timely filed in advance of liquidation as required by the statutory wording. The Government takes this position even though no §507(c) termination tax would have been owed and accordingly no federal governmental interest was prejudiced.

Under §507, if a private foundation is terminated, a tax is imposed on all

transfers. ("§507(c) tax") That tax is to be the lesser of the value of the net assets of the private foundation or the "aggregate tax benefit" realized by the foundation. The aggregate tax benefit is the combined total of the taxes the donors would have paid if the donations were not treated as tax exempt, plus all income taxes the organization would have paid over the years. It has been stipulated in this proceeding that the Bonner Trust had an aggregate tax benefit of zero dollars. Because of the time of the creation of the Trust in 1905, and the manner in which the Trust was operated, there was never any estate, gift or income tax due. Hence, it is agreed that if the Trustees had filed a timely notice, the Trust could have liquidated without the payment of any tax under §507. But because of the failure to notify the Commissioner of the Court order,

a penalty tax of 110% on the amount of the distribution was levied on the Trust, and the Petitioners herein are liable for a portion of this tax as transferees of the Bonner Trust.

Tax Court, in its decision, William Kelly Gladney v. Commissioner, T.C. Memo 1982-708, filed December 6, 1982, ¶82,708 P-H T.C. Memo (1982) held that the Board of the Bonner Trust had in fact substantially complied with the statute because of the unique facts and circumstances involved. At the time the Board closed the Bonner Home on July 1, 1971, no notification had been received from the Internal Revenue Service that the Home was in fact classified as a private foundation within the meaning of §509(a). In fact, by its letter dated July 9, 1971, the Internal Revenue Service notified the Board that it was waiting for the promulgation of the

Treasury Regulations under §509 before it could rule on the Board's request for foundation status for the Trust. Such notification was received in a letter dated October 5, 1971, when the Internal Revenue Service informed the Board that it was a private operating foundation. Tax Court issued its decision based on the fact that the Board's charitable operation had been closed down for about six months at the time when the District Court judgment was entered that the Board's §507(c) tax was zero, and that the Commissioner had not taken any public position in furtherance of its statutory obligation under §507 to prescribe by regulations the time and manner in which an organization was to notify the Government of an intent to terminate its private foundation status. In fact, regulations under §507(a) were not even proposed until April 22, 1972 (37 Fed.

Reg. 7986), months after the dissolution of the Trust.

The Board distributed its assets on January 18 and March 13, 1972, and filed a final notice of liquidation with the Internal Revenue Service on a form dated October 24, 1973, indicating that the Trust had been dissolved and final distributions of the assets had been made pursuant to a Court order. The Tax Court based its result, in part, on the fact that:

> The statute itself does not define the event that constitutes a termination nor does it provide for either the time or manner of notification (Gladney, supra at ¶82-3095).

The Tax Court further indicated that its result was consistent with Congress' clear policy of imposing regulatory-type burdens in exchange for benefits. The Tax Court indicated that the Commissioner had been given ample authority under §507(a)

to establish procedures to protect the integrity of the statutory scheme by the time of the distribution of the Bonner assets. The Tax Court reached this result because, as was agreed to by the Government, there was simply no tax abuse in the formation of the operation of the Bonner Trust to justify the imposition of penalty sought by the Government since the aggregate tax benefits under §507(c) was zero.

The Fifth Circuit in reversing and remanding the decision of the Tax Court based its conclusion on a elusive and erroneous public policy justification. The Fifth Circuit indicated that a related purpose of the 1969 Act was to enhance regulation of private foundations by the states. Petitioners agree. The Fifth Circuit indicated that to further this goal, Congress enacted §6104(c)(1)(B), which requires the Internal

Revenue Service to "notify the appropriate State official of the mailing of a Notice of Deficiency of tax imposed under §507 or Chapter 41 or 42". Chapter 42 contains the excise tax provisions including §4945 for taxable expenditures. The legislative history to the provisions explains the notice requirement of these provisions as follows:

> In order to facilitate effective enforcement of estate and common law and statutory requirements regarding exempt organizations, the bill directs the Internal Revenue Service to notify the appropriate compliance state officer (Attorney General, tax officer, or other official charged with overseeing charitable organizations) of ... (3) the mailing of a Notice of Deficiency regarding the tax described below". Change of "Status" or any of the taxes described above relating to self- dealing income distributions, business holdings, jeopardizing of charitable pur-

> poses, and improper expenditures" Rep. No. 413, 91st Cong., 1st Sess. 36, reprinted in 1969 U.S. Code Cong. & Ad. News at 1682.

However, such public policy justification is totally spurious in the instant case. The Internal Revenue Service would be unable to notify the appropriate state officials here because no notice of deficiency would, or could, ever be issued. Under the applicable statutory provisions, a notice of deficiency can only be issued in the event that a tax is due. The Government has agreed that no §507 tax would have been owed here, which is the only tax applicable if appropriate notification had been made under §507. As no tax is due, no notice of deficiency can be issued.

Procedural due process imposes constraints on Governmental decisions which deprive individuals of "liberty" or

"property" within the meaning of the Due Process Clause of the Fifth Amendment. Mathews v. Eldridge, 424 U.S. 319, 332 (1976). Underlying the due process clause is the fundamental principle that statutes and regulations which purport to govern conduct must give adequate warning of what they command or forbid. A person of ordinary intelligence must be given a reasonable opportunity to know what is prohibited so that he may be free to steer between lawful and unlawful conduct. Grayned v. City of Rockford, 408 U.S. 104, 108 (1972). While this principle applies especially to statutes regulating first amendment rights, even a regulation which governs purely economic or commercial activities, if its violation can engender penalties, must be so framed as to provide a consitutionally adequate warning to those whose activities are governed. See, Joseph

E. Seagram & Sons, Inc. v. Hostetter, 384 U.S. 35, 48-50 (1966); Boyce Motor Lines v. United States, 342 U.S. 337, 340 (1952); Diebold, Inc. v. Marshall, 585 F.2d 1327, 1336 (6th Cir. 1978). The taxpayer may justly demand to know when and how he becomes liable for taxes. Untermyer v. Anderson, 276 U.S. 440 (1928).

The statutory provisions of the private foundation rules, including §§4945 and 507, did not provide Petitioners with a constitutionally sufficient warning that a confiscatory penalty would be applied to the court ordered dissolution of the Bonner Trust.

The statutory provisions are too ambiguous and vague. Section 4945(d), as relevant here, defines a taxable expenditure as "any amount paid or incurred by a private foundation for any purpose other than one qualifying" as a charitable

deduction. The important point here is the common sense understanding of the key phrase "paid or incurred by a private foundation". The order of the Louisiana Civil District Court, in fact, dissolved the Bonner Trust. Such dissolution only required a transfer of title to property of the Trust to heirs at law of Lelia Bonner Dwyer, under Louisiana law, ownership was already in the heirs. In no sense, can it be said that the private foundation, in fact, "paid or incurred" the amount of the transfer directed by the court. Such a statutory provision, without adequate guidelines in the regulations, cannot be considered as providing constitutionally adequate warnings of the imposition of the confiscatory penalty which was applied to the Dwyer heirs.

It should be much more logically assumed by Petitioners that such a court ordered dissolution of a trust would fall within the provisions of §507, dealing with the termination of private foundation status. That section provides, as is relevant here, that:

> The status of any organization as a private foundation shall be terminated only if--
>
> (1) Such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination. . .
>
> and. . . such organization pays the tax imposed by subsection (c) . . .

While it might be reasonable to assume that a court ordered dissolution of a trust should also be a "termination" under §507, the statutory provision does not define what a termination is nor what notice is to be provided. Although the statutory provisions suggest that rules and

regulations be promulgated by the Secretary, such rules and regulations were not, in fact, promulgated at the time that the Louisiana District Court dissolved the Trust.

In normal circumstances, this statute may provide a constitutionally adequate warning to those whose activities are governed. However, the statute fails to give sufficient warning under the unusual facts in the instant case - where the Trust which was acting as a private foundation was dissolved by order of a Louisiana court. If the statutory provisions involved were revenue producing measures, i.e., taxation statutes within the commonly accepted sense of the meaning, such vagueness might be permissible. However, as is indicated by both of the courts below, the private foundation statutes are purely regulatory in nature and if

successful, no additional revenue would be raised for the Government. Therefore, these provisions must be tested constitutionally as penalty statutes and not as revenue measures.

Both of the courts below and the Government have recognized the fact that if the Board of Trustees of the Bonner Home had, in fact, filed a notice with the Internal Revenue Service under §507, no tax would have been owed and no penalty incurred. But failing to supply such notice, according to the Government, results in a 100% confiscation of all of the assets of the Bonner Trust. Such an excessive penalty must be considered in connection with the vagueness of the statutory scheme and its application here. It can be hardly said that the statutory wording of §§4945 and 507 supply sufficient warning to a person of ordinary

intelligence of what is prohibited so that he may order his conduct. These provisions must be considered impermissibly vague and ambiguous in that they did not supply sufficient warnings to Petitioners.

It is important not to lose sight of the fact that no legitimate governmental purpose exists for the application of such an excessive penalty in this case. First, these penalties were primarily designed to prevent tax abuse on the part of private foundations. However, as the Fifth Circuit recognized, there is no tax abuse here because the aggregate tax benefit from the transactions involved with the creation and operation of the Bonner Trust was zero. The Fifth Circuit chose to rely on the fact that the statutory scheme also provides for a notification of state officials in the event of a termination of a private foundation. However, as discussed above,

no state official would have been notified in this case because no notice of deficiency could be issued because no tax was due. Accordingly, imposition of the penalty here serves no governmental purpose.

Procedural due process requires that the Government's application of the impermissibly vague statutory provisions of §§4945 and 507 must be considered unconstitutional since they do not provide a constitutionally adequate warning to those whose activities are governed. If the Bonner Trustees had filed a meaningless piece of paper or "notice" with the Internal Revenue Service, the Service would not be able to stop the liquidation, no tax would have been owed, and no penalties asserted. But because of the failure to file a notice, the character of which is not defined or outlined in the statute, the

Government is able to confiscate 100% of the assets of the Trust. Such a result must be considered unconstitutional. This arbitrary and unreasonable application of penalty excise tax statutory provisions to effect the confiscation of the vested rights and property of the heirs of Lelia Dwyer Bonner constitutes an important question of constitutional law which should be decided by this Court.

# CONCLUSION

For the foregoing reasons -- as well as any additional reasons presented by other parties who may seek certiorari to review the Fifth Circuit's decision -- the Petition for Certiorari should be granted. The law created by the decision of the Court of Appeals in the instant case conflicts with the law established by this Court and raises constitutional questions of general importance in the application and administration of the tax laws which should be reviewed.

Respectfully submitted,

LEONARD R. NACHMAN, II

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830 NORTH STREET
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# CERTIFICATE OF SERVICE

I, Leonard R. Nachman, II, Counsel of Record for William F. Bonner, Jr., et. al., Petitioners, and a member of the Bar of the Supreme Court of the United States, hereby certify that three (3) copies of the foregoing Petition for Certiorari have been served, on this 3rd day of April, 1985, on each of the following, in each case by deposit of the copies to be served in a United States post office in Baton Rouge, Louisiana, with first class postage prepaid, properly addressed as follows:

1. Addressee: THE SOLICITOR GENERAL, Department of Justice, Washington, D.C. 20530

2. Addressee: GLENN L. ARCHER, JR., Assistant Attorney General, Tax Division, Department of Justice, Washington, D.C. 20530, ATTN: MICHAEL L. PAUP, WILLIAM S. ESTABROOK and DAVID I. PINCUS, Attorneys and Counsel of Record for Commissioner of Internal Revenue

It is hereby certified that all parties required to be served with the foregoing Petition for Certiorari have been listed and served as of this 3rd day of April, 1985, in the manner described hereinabove.

Leonard Nachman

LEONARD R. NACHMAN, II,

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# APPENDIX A

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

### Constitution of the United States

Fifth Amendment (in relevant part):

No person shall * * * be deprived of life, liberty, or property, without due process of law * * *.

### Internal Revenue Code of 1954 (26 U.S.C.):

(The provisions of the Internal Revenue Code are set forth in this Appendix as they were effective for 1972, the taxable year at issue.)

SEC. 507 [as added by Sec. 101(a), Tax Reform Act of 1969.] TERMINATION OF PRIVATE FOUNDATION STATUS.

(a) General Rule.--Except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if--

(1) such organization notifies the Secretary or his delegate (at such time and in such manner as the Secretary or his delegate

may by regulations prescribe) of its intent to accomplish such termination, or

(2)(A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act or failure to act), giving rise to liability for tax under chapter 42, and

(B) the secretary or his delegate notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c);

and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

* * * * *

(c) Imposition of Tax.--There is hereby imposed on each organization which is referred to in subsection (a) a tax equal to the lower of--

(1) the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or

(2) the value of the net assets of such foundation.

(d) Aggregate Tax Benefit.--

(1) In general.--For purposes of subsection (c), the aggregate tax benefit resulting from the section 501(c)(3) status of any private foundation is the sum of--

(A) the aggregate increases in tax under chapters 1, 11 and 12 (or the corresponding provisions of prior law) which would have been imposed with respect to all substantial contributors to the foundation if deductions for all contributions made by such contributors to the foundation after February 28, 1913, had been disallowed, and

(B) the aggregate increases in tax under chapter 1 (or the corresponding provisions of prior law which would have been imposed with respect to the income of the private foundation for taxable years beginning after December 31, 1912, if (i) it had not been exempt from tax under section 501(a) (or the corresponding provisions of prior law), and (ii) in the caes of a trust, deductions under section 642(c) (or the corresponding provisions of prior law) had been limited to 20 percent of the taxable income of the trust (computed without the benefit of section 642(c) but with the benefit of section 170(b)(1)(A)), and

(C) interest on the increases in tax determined under subparagraphs (A) and (B) from the first date on which each such increase would have been due and payable to the date on

which the organization ceases to be a private foundation.

* * * * *

(f) Liability in Case of Transfers of Assets From Private Foundation.--For purposes of determining liability for the tax imposed by subsection (c) in the case of assets transferred by the private foundation, such tax shall be deemed to have been imposed on the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation.

SEC. 4945 [as added by Sec. 101(b), Tax Reform Act of 1969.] TAXES ON TAXABLE EXPENDITURES.

(a) Initial Taxes.--

(1) On the foundation.--There is hereby imposed on each taxable expenditure (as defined in subsection (d)) a tax equal to 10 percent of the amount thereof. The tax imposed by this paragraph shall be paid by the private foundation.

* * * * *

(b) Additional Taxes.--

(1) On the foundation.--In any case in which an initial tax is imposed by subsection (a)(1) on a taxable expenditure and such expenditure is not corrected within the correction period, there is hereby imposed a tax equal to 100 percent of the amount of the expenditure. The tax imposed by this paragraph shall be paid by the private foundation.

* * * * *

(d) Taxable Expenditure.--For purposes of this section, the term "taxable expenditure" means any amount paid or incurred by a private foundation--

* * * * *

(5) for any purpose other than one specified in section 170(c)(2)(B).

* * * * *

SEC. 6104 (as added by Sec. 101(e)(2), Tax Reform Act of 1969.] PUBLICITY OF INFORMATION REQUIRED FROM CERTAIN EXEMPT ORGANIZATIONS AND CERTAIN TRUSTS.

(c) Publication to State Officials.--

(1) General Rule.--In the case of any organization which is described in section 501(c)(3) and exempt from taxation under section 501(a), or has applied under section 508(a) for recognition as an organization described in section 501(c)(3), the Secretary or his delegate at such times and in such manner as he may by regulations prescribe shall--

* * * * *

(B) notify the appropriate State officer of the mailing of a notice of deficiency of tax imposed under section 507 or chapter 42, and

* * * * *

(2) Appropriate State Officer.--For purposes of this subsection, the term "appropriate State officer" means the State attorney general, State tax officer, or any State official charged with overseeing or-

ganizations of the type described in section 501(c)(3).

**Louisiana Civil Code of 1870**:

ART. 490:

Ownership is divided into perfect and imperfect.

Ownership is perfect, when it is perpetual, and when the thing is unincumbered with any real right towards any other person than the owner.

On the contrary, ownership is imperfect, when it is to terminate at a certain time or on a condition, or if the thing, which is the object of it, being an immovable, is charged with any real right towards a third person; as a usufruct, use or servitude.

When an immovable is subject to a usufruct, the owner of it is said to possess the naked ownership.

ART. 491:

Perfect ownership gives the right to use, to enjoy and to dispose of one's property in the most unlimited manner, provided it is not used in any prohibited by laws or ordinances.

Persons who reside out of the State, can not dispose of the property they

possess here, in a manner different from that prescribed by its laws.

ART. 492:

Imperfect ownership only gives the right of enjoying disposing of property, when it can be done without injuring the rights of others; that is, of those who may have real or other rights to exercise upon the same property.

ART. 940:

A succession is acquired by the legal heir, who is called by law to the inheritance, immediately after the death of the deceased person to whom he succeeds.

This rule applies also to testamentary heirs, to instituted heirs and universal legatees, but not to particular legatees.

ART. 941:

The right mentioned in the preceding article is acquired by the heir by the operation of the law alone, before he has taken any step to put himself in possession, or has expressed any will to accept it.

Thus children, idiots, those who are ignorant of the death of the deceased, are not the less considered as being

seized of the succession, though they be merely seized of right and not in fact.

ART. 942:

The heir being considered seized of the succession from the moment of its being opened, the right of possession, which the deceased had, continues in the person of the heir, as if there had been no interruption, and independent of the fact of possession.

ART. 943:

The right of possession, which the deceased had, being continued in the person of his heir, it results that this possession is transmitted to the heir with all its defects, as well as all its advantages, the change in the proprietor producing no alteration in the nature of the possession.

Thus the extent of the rights of the deceased regulates those of the heir, who succeeds to all his rights which can be transmitted, that is, to all those which are not, like usufruct, attached to the person of the deceased.

ART. 944:

The heir is being considered as having succeeded to the deceased from the instant of his death, the first effect

of this right is that the heir transmits the succession to his own heirs, with the right of accepting or renouncing, although he himself have not accepted it, and even in case he was ignorant that the succession was opened in his favor.

ART. 945:

The second effect of this right is to authorize the heir to institute all the actions, even possessory ones, which the deceased had a right to institute, and to prosecute those already commenced. For the heir, in every thing, represents the deceased, and is of full right in his place as well for his rights as his obligation.

ART. 946:

Though the succession be acquired by the heir from the moment of the death of the deceased, his right is in suspense, until he decide whether he accepts or rejects it.

If the heir accept, he is considered as having succeeded to the deceased from the moment of his death; if he rejects it, he is considered as never having received it.

ART. 947:

The heir, who accepts, is considered as having succeeded to the deceased

from the moment of his death, not only for the part of the succession belonging to him in his own right, but for the parts accruing to him by the renunciation of his coheirs in the succession of the deceased.

ART. 948:

When all the heirs in the nearest degree renounce the succession, which is accepted by those in the next degree, these last are considered as having succeeded directly and immediately to the rights and effects of the succession from the moment of the death of the deceased.

Therefore the heirs, thus succeeding by the renunciation of relations nearer in degree, transmit the succession to their own heirs, if they die before having accepted it, in the same manner as if they had succeeded in the first degree to the deceased.

ART. 949:

Natural children and the surviving husband or wife before being put into possession of the estate left to them, are not considered as having succeeded to the deceased from the instant of his death; but they do not the less transmit their rights to their heirs, if they die before having made their demand to be put into possession. The reason is, that this sort of heirs

having only a right of action to cause themselves to be put into possession of successions thus falling to them, this right and this action form a part of their succession, which they transmit to their heirs.

ART. 1523:

There are three kinds of donations inter vivos:

The donation purely gratuitous, or that which is made without condition and merely from liberality;

The onerous donation, or that which is burdened with charges imposed on the donee;

The remunerative donation, or that the object of which is to recompense for services rendered.

ART. 1527:

The donor may impose on the donee any charges or conditions he pleases, provided they contain nothing contrary to law or good morals.

ART. 1559:

Donation [Donations] inter vivos are liable to be revoked or dissolved on account of the following causes:

1. The ingratitude of the donee;

2. The non-fulfillment of the eventual conditions, which suspend their consummation;

3. The non-performance of the conditions imposed on the donee;

4. The legal or conventional return.

ART. 1696:

The sale, made by the testator, of an object bequeathed, even by act under private signature, after the date of the testament, produces a revocation of the legacy, if the act be entirely written, signed and dated with his hand.

ART. 1697:

The testamentary disposition becomes without effect, if the person instituted or the legatee does not survive the testator.

ART. 1698:

Every testamentary disposition made on a condition depending on an uncertain event, so that in the intention of the testator the disposition shall take place only inasmuch as the event shall or shall not happen, is without effect, if the instituted heir or the legatee dies before the accomplishment of the condition.

### ART. 1699:

A condition which, in the intention of the testator, does but suspend the execution of the disposition, does not hinder the instituted heir or the legatee from having a right acquired and transmissible to his heirs.

### ART. 1704:

Legatees under a universal title, and legatees under a particular title, benefit by the failure of those particular legacies which they are bound to discharge.

### ART. 1709:

Except in the cases prescribed in the two preceding articles, every portion of the succession remaining undisposed of, either because the testator has not bequeathed it, either to a legatee or to an instituted heir, or because the heir or the legatee has not been able, or has not been willing to accept it, shall devolve upon the legitimate heirs.

### ART. 1710:

The same causes which, according to the foregoing provisions of the present title, authorize an action for the revocation of a donation inter vivos, are sufficient to ground an action of revocation of testamentary disposi-

tions; provided, however, that no charges or conditions can be imposed by the testator on the legitimate portion of forced heirs, nor can they lose their inheritance for any act of ingratitude to the testator, prior to his decease. That he has not disinherited them shall be sufficient evidence of his having forgiven the offense.

ART. 2021:

Conditional obligations are such as are made to depend on an uncertain event. If the obligation is not to take effect until the event happen, it is a suspensive condition; if the obligation takes effect immediately, but is liable to be defeated when the event happens, it is then a resolutory condition.

ART. 2023:

The casual condition is that which depends on chance, and is no way in the power either of the creditor or of the debtor.

ART. 2026:

Conditions are either express or implied. They are express, when they appear in the contract; they are implied, whenever they result from the operation of law, from the nature of

the contract, or from the resumed intent of the parties.

ART. 2028:

The contract of which the condition forms a part is, like all others, complete by the assent of the parties; the obligee has a right of which the obligor can not deprive him; its exercise is only suspended, or may be defeated, according to the nature of the condition.

ART. 2029:

The right, described in the last preceding article, is heritable, if it be not one of those that result from an obligation designated in the preceding section as a personal one.

ART. 2030:

The right acquired by a legatee under a conditional bequest, is the same as that given to an obligee by contract, and creates a corresponding obligation on the heirs to deliver the legacy on the happening of the condition. But there is this difference, that (except the case provided for in the last preceding section, of the condition to do a merely personal act), the right is not transmitted to the heirs of the legatee, in case he die before the condition happens, unless the testator has expressed a different intention.

ART. 2045:

The dissolving condition is that which, when accomplished, operates the revocation of the obligation, placing matters in the same state as though the obligation had not existed.

It does not suspend the execution of the obligation; it only obliges the creditor to restore what he has received, in case the event provided for in the condition takes place.

# APPENDIX B

William Kelly Gladney,
Evelyn Gladney Witherspoon,
Celeste Gladney Peers,
Julian M. Gladney and
Edward Lee Gladney,
Transferees, Petitioners-Appellees

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.

William F. Bonner, Jr.,
Estate of Bettina Bonner,
William F. Bonner, Jr., Executor,
Transferees, Petitioner-Appellees
Cross-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant
Cross-Appellee.

Nos. 83-4229, 83-4379.

United States Court of Appeals,
Fifth Circuit

Before TIMBERS,* POLITZ and RANDALL, Circuit Judges.

TIMBERS, Circuit Judge:

The Commissioner of Internal Revenue appeals from a decision of the

United States Tax Court, Herbert L. Chabot, Judge, 45 T.C. Mem. 280 (1982), holding that the taxpayers (appellees) were not liable for federal excise taxes under §4945[1] as transferees of taxable expenditures made by a private foundation, i.e. by the board of trustees of a home for elderly men. A Louisiana state court had ordered the transfer of assets from the private foundation to the heirs of the residuary legatees under a will in which the decedent originally had created the foundation. The Tax Court concluded, contrary to the arguments of the IRS, that the state court judgment operated to terminate the board's private foundation status and that reports filed by the board subsequent to the transfer satisfied the statutory notice requirements.

For the reasons stated below, we hold that the decision of the Tax Court is not supported by the 1969 Act, particularly in light of its legislative history. We reverse and remand.

## I.

The facts, having been stipulated, are not in dispute.

We shall summarize only those facts and prior proceedings believed necessary to an understanding of our ruling on the legal issues raised on this appeal.

Lelia Bonner Dwyer died testate on June 22, 1905. In her will, Mrs. Dwyer directed that the real estate she owned be sold. She further directed that a portion of the proceeds be used by a group of named individuals as trustees to found and maintain in New Orleans a home for aged and infirm men to be called the John M. Bonner

Memorial Home (the Home). Mrs Dwyer's first cousins in due course became her substitute residuary legatees. They were placed in possession of all property remaining after payment of specific legacies named in Mrs. Dwyer's will. The heirs on this appeal are descendants of those first cousins.

On July 13, 1905, the surviving trustees named in the will organized a charitable corporation known as the Board of Trustees of the John M. Bonner Memorial Home (the Board). The surviving trustees under the will were the trustees of the Board. The Board completed construction of the Home in 1915. The Home operated at a capacity of about twenty resident men until the early 1950's. During the 1950's, the number of residents of the Home began to decrease. The Home at this time also

experienced financial difficulties. It began to draw upon its endowment to pay operating expenses.

In 1963, the heirs sued the Board in the Louisiana Civil District Court. They alleged that the trust had been completely fulfilled and no longer could be operated as originally contemplated. They requested that the trust be dissolved and that the remaining assets be delivered to them. The court's judgment in favor of the Board and against the heirs was affirmed on appeal. The Court of Appeal of Louisiana, Fourth Circuit, in affirming, pointed out that five men remained in the home and that funds were available to care for them, even though only for a few more years. Bonner v. Board of Trustees, 181 So.2d 255, 258 (La. App. 1965), writ denied, 248 La. 915, 182 So.2d 664 (1966).[2]

In 1970, the Board responded to a letter from the IRS by filing a statement that the Board was a private foundation within the meaning of §509(a) and claimed that it was an operating foundation within the meaning of §4942(j)(3).

On July 1, 1971, the Board closed the Home because the cost of operations significantly exceeded the revenues of the trust fund. At that time the Home had only two residents.

In a letter dated July 9, 1971, the IRS notified the Board that it was waiting for promulgation of Treasury Regulations under § 509 before it could rule on the Board's request for foundation status for the Home. In a letter dated October 5, 1971, the IRS informed the Board that it had been classified as a private

foundation under § 509(a) and as an operating foundation under § 4942(j)(3).

On November 5, 1971, the heirs filed a petition in a declaratory judgment action in the Louisiana Civil District Court requesting that the trust be dissolved because of non-performance of the conditions imposed by the donor and that the heirs be declared entitled to the remaining assets. The Board responded that the Home had been closed, it was impractical to continue the trust, and the trust established by Mrs. Dwyer had been fulfilled satisfactorily. The Board left to the court the decision whether the remaining assets should be delivered to the heirs or diverted to another cause under the doctrine of cy pres.[3] On December 23, 1971, the court entered its judgment. It agreed with the heirs and ordered the

assets distributed to them. One of the trustees concluded and recommended to the Board that the judgment was based on a factual determination and thus there was no basis for an appeal. Accordingly, on January 18 and March 13, 1972, the Board delivered the remaining assets, valued at $200,596, to the heirs in equal parts. After delivery of the assets to the heirs, the Board carried on only minimum ministerial functions.

The Board filed with the IRS a form dated October 24, 1973. This form was known as "Form 966-E Liquidation, Dissolution, Termination or Substantial Contraction of Organizations Exempt or Formerly Exempt under Section 501(a)". In this form, the Board stated that it had been dissolved and that final distribution of assets had been made. The Board made

similar statements in subsequent filings with the IRS.

On March 21, 1977, the IRS mailed notices to each of the heirs asserting excise tax liability. The notices stated that the excise tax liability of the heirs resulted from their status as transferees of non-charitable expenditures by a private foundation as provided for in § 4945. The notices asserted liability in the amount of $30,081.28 against each heir-transferee, or a total of $210,568.96.[4]

In June 1977, the heirs filed petitions in the Tax Court[5] challenging the Commissioner's determination that the Board had incurred § 4945 excise tax liability and his assertion that the heirs were liable as transferees of the Board's assets.

On December 6, 1982, the Tax Court filed its memorandum decision holding that the heirs were not liable as transferees because the Board was not liable for the § 4945 excise tax. Gladney v. Commissioner, 45 T.C.M. 280 (1982).

The Tax Court held that the Board's private foundation status was terminated upon the entry of the 1971 judgment of the Louisiana Civil District Court and that transfers of assets in accordance with that judgment did not give rise to tax liability. The Tax Court also held that any federal statutory notification requirements were satisfied by the Board's filings after the distributions of the assets. The Commissioner's post-decision motions were denied by the Tax Court. He now appeals from that decision and the Bonner heirs cross-appeal.

## II.

We turn first to the question of whether the Board terminated its foundation status and notified the IRS so as to avoid liability under § 4945.

Under § 501(c)(3), organizations, like the Home, which provide desirable social and charitable functions, are exempt from federal income taxes. As in any other area where both people and taxes are involved, however, abuses did occur. Prior to the enactment of the 1969 Act, the sole penalty for abuse was the loss of an organization's exempt status. In §§ 4940-4945 of the 1969 Act, Congress enacted a series of excise taxes designed to regulate the activities of tax exempt organizations.[6] Section 4945, the provision before us in this case, imposes taxes on amounts expended by the foundation

for other than specified (charitable or the like) purposes.[7]

Under § 507, an organization may terminate its status as a private foundation by notifying the IRS. Under that section, however, a tax is imposed on an organization which has terminated its private foundation status.[8]

The Tax Court concluded that the Board's private foundation status was terminated in the instant case upon the entry of the 1971 judgment of the Louisiana Civil District Court. The Tax Court based its conclusion on three facts or circumstances:

> "At the time the District Court judgment was entered and the Board determined not to appeal, (1) the Board's charitable operation had been closed down for about six months, (2) the Board's section 507(c) tax was zero,[9] and (3) respondent had not taken any public position in furtherance of his statutory obligation under

> section 507(a)(1) to prescirbe by regulations the time and manner in which an organization was to notify respondent of an intention to terminate its private foundation status."

Gladney v. Commissioner, supra, 45 T.C.M. at 288 (footnote added). In addition to these facts or circumstances, the Tax Court stated that its conclusion was "consistent with the Congress' clear policy of imposing regulatory-type burdens in exchange for tax benefits". Id. at 289.

In view of our interpretation of the statutory provisions in question and their underlying purposes, as explained below, we find the circumstances relied on by the Tax Court to be unconvincing, its statement of Congressional policy to be not altogether accurate, and its conclusion to be erroneous.

[1] We shall consider first the facts and circumstances of the case relied

on by the Tax Court. The fact that the Board's charitable operation had been closed for six months prior to the judgment of the Louisiana Civil District Court in our view is irrelevant to the issue before us. We agree with the IRS that "termination" as used in § 507 is a statutory term of art which refers only to the organization's legal status, not to its operational status. The Tax Court ignored this critical distinction.

[2] Turning next to the third factual circumstance relied on by the Tax Court, we hold that the failure of the IRS to promulgate regulations under § 507(a)(1) by the time the Board made the challenged distributions[10] did not relieve the Board of its duty under the statutory notice requirement. The statute on its face clearly requires notice before termination

of private foundation tax status can take place. The fact is that two years elapsed between the time of the alleged termination (the date of the state court judgment) and the time the Board gave any notice whatsoever. It might be different if the IRS were asserting that the Board's notice of termination did not conform to regulations which were not as yet promulgated at the time of the notice. That is not this case. Here, by failing to give the Secretary timely notice, in any manner, the Board did not comply with the statutory requirement of § 507.

The final factual circumstance relied on by the Tax Court - that the Board had no § 507(c) tax benefits - dovetails with the court's interpretation of the policy behind the notice requirement. The court concluded that the policy is to

permit the IRS to compute the termination tax under § 507(c), i.e., to impose regulatory type burdens in exchange for tax benefits. That tax would have been zero in this case. If computation of the § 507(c) termination tax were the sole purpose of the notice, then it might be said that only the most slavish reading of the statute would require the taxpayers to pay the excise tax. We hold, however, that the notice requirement, as part of a larger statutory scheme, has other important purposes which the Tax Court wholly overlooked.

[3, 4] The approach of Congress in the private foundation provisions of the 1969 Act, as reflected in the various reporting and notice provisions, was "'to locate and maintain contact with the foundations'". Jackson v. Statler

Foundation, 496 F.2d 623, 633 (2d Cir.1974), cert. denied, 420 U.S. 927 (1975), quoting Private Foundations under the Tax Reform Act of 1969, 7 Colum.J.Law & Soc.Prob. 240, 254 (1971). This is reinforced by our independent examination of the legislative history.

The Congressional materials clearly indicate that one purpose of the statutory scheme was to provide the IRS with more information. For example, in explainting the reasons for the change of status provisions, §§ 507-509, the Senate report stated:

> "The House and the committee believe that the Internal Revenue Service has been handicapped in evaluating and administering existing laws by the lack of information with respect to many existing organizations."

S.Rep. No. 552, 91st Cong., 1st Sess. 54, reprinted in 1969 U.S.Code Cong. & Ad. News 2027, 2081.

Another related purpose of the 1969 Act was to enhance regulation of private foundations by the States. For example, the House explained the reasons for the new disclosure and publicity requirements, §§ 6033, 6034, 6104, and 6652, as follows:

> "The primary purpose of these requirements is to provide the Internal Revenue Service with information needed to enforce the tax laws. The experience of these past two decades has indicated to your committee that more information is needed, on a more current basis, from more organizations, and that this information must be made available to more people, especially State officials."

H.R.Rep. No. 413, 91st Cong., 1st Sess. 36, reprinted in 1969 U.S.Code Cong. & Ad. News 1645, 1681. Toward this goal, Congress

provided in §6104(c)(1)(B) that the IRS shall "notify the appropriate State officer of the mailing of a notice of deficiency of tax imposed under section 507 or chapter 41 or 42". Chapter 42 contains the excise tax provisions, including § 4945 for taxable expenditures. The House explained the notice requirement of these provisions as follows.

> "In order to facilitate effective enforcement of State common law and statutory requirements regarding exempt organizations, the bill directs the Internal Revenue Service to notify the appropriate State officer (attorney general, tax officer, or other official charged with overseeing charitable organizations) of:
>
> ... (3) the mailing of a notice of deficiency regarding the tax described below in "Change of Status" or any of the taxes described above relating to self-dealing, income distributions, business holdings, jeopardizing of charitable purposes, and improper expenditures."

H.R.Rep. No. 413, _supra_, at 37, _reprinted in_ 1969 U.S.Code Cong. & Ad.News at 1682.[11]

[5] In the instant case, the informational purpose of the Congressional plan was thwarted. Untimely notification to the IRS resulted in no notification to State officials that the Board was prepared to turn over its assets to private parties. If State officials had been notified, the State might have intervened in the state court action as parens patriae to protect the charity. Speculation as to what State officials might have done here is not essential to our holding. We find it is sufficient that (1) the Commissioner has shown that a taxable expenditure took place before the Board notified the IRS under § 507 and (2) there is a clear congressional intent to require private

foundations to comply with the information regulations - even a foundation which has no "termination tax" liability. The IRS was unaware of the dissolution of this foundation for two years. To affirm the Tax Court decision and therefore to allow foundations to act without the knowledge of the IRS or State officials would constitute a precedent striking a severe blow at the carefully articulated information purpose of the Congressional plan. We decline to do so.[12]

Appellees advance two additional arguments. First, they argue that the Board substantially complied with § 507. Second, they argue that the IRS was not prejudiced by the Board's failure to notify the IRS of its intention to terminate. These closely related arguments are based for the most part on the same mistaken

interpretation of the Congressional policy underlying § 507 which the Tax Court relied upon. They can be dismissed in light of the broader legislative history analysis set forth above. We nevertheless add a few comments.

[6] On the issue of substantial compliance, appellees cite Rickey v. United States, 592 F.2d 1251 (5th Cir.1979) (substantial compliance doctrine applicable where taxpayer failed to comply with filing date requirements set forth in regulations relating to waiver of § 318 attribution rules). In Rickey, we rejected a "crabbed reading of the Code when the [Congressional] rationale for applying a rule is absent". Id. at 1258. In the instant case, on the contrary, there is a clear Congressional rationale for applying the notice requirements. In light of the

information gathering rationale, after-the-fact notification is not substantial compliance.

On the issue of prejudice, appellees argue that the procedural notification requirement does not relate to the substance of § 507. As explained above, failure to notify the IRS and, indirectly, State officials, does relate to the very heart of the Congressional plan to give these authorities sufficient information.

We find these two arguments, as well as appellees' other related contentions regarding the applicability of § 4945, to be without merit.

## III.

The Bonner appellees present two additional arguments which were not ruled upon by the Tax Court. They are urged upon

us as alternative grounds for affirming the judgment of the Tax Court. First, appellees argue that the Bonner Home was a split interest trust and therefore dissolution of the Home was not subject to the private foundation rules. Second, they argue that application of § 4945 would result in a denial of due process. We shall consider these arguments seriatim.

(A)

Section 4947(a)(2) provides that private foundation excise taxes, including those provided for in § 4945, shall apply to a split interest trust.[13] Section 4947(a)(2)(C), however, carves out an exception, namely, that § 4947(a)(2) shall not apply to any amounts transferred to a split-interest trust prior to May 27, 1969. In the instant case, all of the amounts transferred to the Board were

transferred prior to May 27, 1969. The Commissioner concedes that, if the Board were a split-interest trust, the private foundation excise taxes would not apply.

Clearly, however, the Board was an exempt organization and thus § 4947 does not apply. The Board represented itself to the IRS for over twenty years as an exempt organization. During that entire period, it was treated as such. For example, in 1950, the Board filed for and received a determination that it was exempt. In 1970, the Board represented that it was an exempt private foundation; in 1971, the IRS notified the Board that it had been classified as such. Moreover, the Board consistently filed reports and returns indicating that it was an exempt organization and a private foundation.

[7] Based on this record, we hold that the Board was not eligible for a § 4947(a)(2) exemption because it was not a split-interest trust for the purposes of the Internal Revenue Code.[14]

(B)

The Bonner appellees further argue that application of §4945 here would deprive them of vested rights they purportedly obtained in 1905 upon the probate of the Dwyer will. This type of retroactive application, they argue, would violate their Fifth Amendment due process rights.

Both sides assert that this type of private foundation excise tax case is similar to federal estate tax cases and that the reasoning of the federal estate tax cases in the Supreme Court involving the retroactivity issue is relevant. We

agree. The federal estate tax case of Fernandez v. Wiener, 326 U.S. 340 (1945), is especially illuminating. In that case, the Court upheld the inclusion in the husband's gross estate of the entire value of the community property owned by him and his wife. The Court so held despite the fact that the couple had married and the wife's rights to the property had "vested" in 1907 - well before the federal estate tax provisions covering community interests were enacted. The wife argued that application of the estate tax provision constituted denial of due process by adding to the concededly valid tax on decedent's share of the community property a further tax on the one-half interest of the surviving spouse. The Court's answer, applicable by analogy to the instant case, was as follows:

> "This redistribution of powers and restrictions upon power is brought about by death notwithstanding that the rights in the property subject to these powers and restrictions were in every sense "vested" from the moment the community began. It is enough that death brings about changes in the legal and economic relationships to the property taxed, and the earlier certainty that those changes would occur does not impair the legislative power to recognize them, and to levy a tax on the happening of the event which was their generating source."

Id. at 356-57. See also United States v. Jacobs, 306 U.S. 363 (1939) (rejecting a similar attack on the constitutionality of a statute imposing estate taxes on the entire property held in joint tenancy).[15]

With these decisions in mind, we turn now to the constitutional attack on the application of §4945. Assuming arguendo that appellees did have vested property rights created in 1905 when the Dwyer will was probated,[16] their

constitutional challenge fails. The dissolution of the trust shifted the interests in the trust assets just as the death of the decedents did to the community property in Fernandez and to the joint tenancy in Jacobs. As in Fernandez and Jacobs, the shift in the instant case took place after enactment of the relevant excise tax statute, i.e., after the enactment of the 1969 Act.

[8] Following the reasoning of the Supreme Court, we hold that the fact that the creation of the "vested" property right took place prior to enactment does not make application of the statute retroactive so as to violate due process.

To summarize: we agree with the Commissioner's contention that appellees are subject to transferee liability. The mandatory language of the applicable

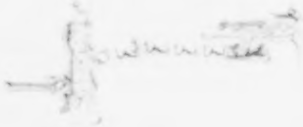
statutes, the overall statutory scheme of private foundation regulation under the 1969 Act, and the Congressional articulation of the policies behind that scheme all require that government officials should have been notified of these transfers.

For the reasons set forth above, we reverse the decision of the Tax Court and remand the case to that court for further proceedings according to law.

REVERSED AND REMANDED.

POLITZ, Circuit Judge, dissenting:

Believing that the tax court was correct in its analysis and result, I respectfully dissent. I am mindful that judicial interpretation and application of the Internal Revenue Code must be based on the language of the Code and, where appropriate, indications of legislative



intent. Notions of equity, right reason and fair play must occasionally be shunted aside. But I am not persuaded that either the language of the Code, taken in historical perspective, or the discernible congressional intent and purpose dictate today's result.

We have before us taxpayers who have inherited what is effectively a residual estate. Under Louisiana law, as applied by the Louisiana courts, these taxpayers were declared owners of the remainder of property which had been placed in a testamentary charitable trust by an ancestor. The trust was established by the last will and testament of Lelia Bonner Dwyer who died on June 22, 1905. The trustees were directed to take the proceeds from the sale of certain property and "found and maintain in New Orleans a home

for aged and infirm men to be called the John M. Bonner Memorial Home."

In 1905 there were no federal estate, gift, or income taxes. No taxes were evaded or avoided by the creation of the trust. Over the years the trustees determined that a non-profit corporation would be a better vehicle for administration of the trust. As reflected by the stipulation of the parties, at no time did the existence or operation of the trust result in an avoidance or evasion of income tax. All income was used for unchallenged trust expenses. A half-century or so after its creation it became apparent that the purpose of the trust could no longer be achieved. The occupancy of the home had dwindled almost to naught. The heirs of Lelia Bonner Dwyer sought and secured a judgment declaring the trust at

an end, and recognizing them as the persons entitled to ownership of the remaining trust assets. Those assest were accordingly distributed.

The facts to me are simple and clear. Property was placed in a charitable trust for a state purpose. At that point in time no estate or gift tax was imposed, thus none was avoided. At no time during the life of the trust was there any taxable income, thus no income tax was avoided. But when the court terminated the trust and recognized the heirs as owners, the tax consequences exploded like a dreaded landmine. According to the majority opinion, which accepts the commissioner's position, because the trustees failed to notify the Secretary timely of their intent to dissolve the corporation and distribute the residual assets as per the judgment of

the Louisiana court, the heirs/taxpayers must pay to the government 110% of the amount received. The tax court disagreed with the commissioner. So did I.

The trust at issue was bona fide from its inception. When the tax code came on the scene, with its provisions for tax exempt entities, the trust qualified under §501(c)(3). Insofar as this record reflects, at all times the trust was operated in a manner consistent with the creating testament and all applicable state and federal laws and regulations. When the law was changed in the late 1960's the trustees dutifully applied for the required tax status. Before the status was ever granted, however, the trust was terminated and the assets were distributed. After completing this distribution the trustees notified the government. Because this

notification came after the fact, the commissioner maintains that the trust made nonexempt expenditures thus subjecting the recipients to the harsh §4945 taxes and surtaxes.

Under §507 if a private foundation, which includes the trust before us, is terminated in a manner inconsistent with the Code provisions, a tax is imposed on all transfers. That tax is to be the lesser of the value of the net assets of the foundation or the "aggregate tax benefit" realized by the foundation. The aggregate tax benefit is the combined total of the taxes the donors would have paid if the donations were not treated as tax exempt, plus all income taxes the organization would have paid over the years. The trust before us had an aggregate tax benefit of zero dollars.

There was never any estate, gift or income tax due. It necessarily follows that there was never any meaningful exemption granted nor any de jure or de facto excusal from tax accountability or responsibility. However, because of a failure of timely notice by the trustees, notice which would have resulted in nothing, the majority sanctions the imposition of a penalty of 110% of the amount of inheritance received by these heirs. To this I cannot subscribe.

The provision of the code is specific; for a proper §507 termination, the exempt organization must give notice:

> The status of any organization as a private foundation shall be terminated only if --
>
> > such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination . . . .

The record is clear. The trustees did not give notice until after the assets were distributed. That was error. I view this error as neither heinous nor culpable; it appears to be simple inadvertance. Right reason demands that this failing or oversight be put in perspective. The tax law was new. All involved were struggling, including the tax experts and the Internal Revenue Service. As of the time of the termination and asset distribution the Secretary had not yet promulgated regulations prescribing the time and manner for the notice of termination, despite the clear legislative directive that he do so. This delay, to me, reflects the apparent difficulty being generally experienced with the new provisions effecting such entities as the Bonner trust. Notwithstanding, the taxpayers are held to knowledge of the law

- the trustees should have given notice. Quite obviously, the taxpayers should have insisted that such be done before they accepted their inheritance. But is that failure a sufficient basis to cause the forfeiture of their entire inheritance plus the payment of an additional 10% penalty? I am persuaded beyond peradventure that Congress intended no such harsh result.

The commissioner assessed the taxpayers for a taxable expenditure under subsection (d)(5) of §4945 - the catch-all phrase: "for any purpose other than one specified in section 170(c)(2)(B)." This phraseology in a vacuum is meaningless; meaning flows from the preceding four sections. The taxable expenditures articulated in §4945(d) reflect the mind of the lawmakers. The following expenditures are abrogated:

> (1) to carry on propaganda, or otherwise to attempt, to influence legislation, within the meaning of subsection (e),
>
> (2) except as provided in subsection (f), to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive,
>
> (3) as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of subsection (g),
>
> (4) as a grant to an organization (other than an organization described in paragraph (1), (2), or (3) of section 509(a)), unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h), or
>
> (5) for any purpose other than one specified in section 170(c)(2)(B).

I do not glean from this language any congressional desire to protect the public fisc from intrusions occasioned by the distribution of trust assets to heirs

of the testamentary settlor. Nor is such reflected in the available fount of legislative history.

> Among the activities which under the ... bill give rise to taxable expenditure are those to influence the outcome of any public election ....
>
> ... where the private foundations spend money on activities generally referred to as lobbying expenditures ... attempts to affect the opinion of the general public.
>
> ... influence legislation by attempting to cause members of the general public to propose, support, or oppose legislation.

Conference Report No. 91-782, for the Tax Reform Act of 1969, reprinted in 1969 U.S. Code Cong. and Ad. News 2392, 2398.

The obvious intent of Congress in adopting §4945 was to reduce, if not eliminate, the opportunity for individuals to create tax-free organizations for the pursuit of their private purposes. Private

after-tax dollars ought to be used for those pursuits, not tax dollars. But that is not the case here presented. Lelia Bonner Dwyer did not provide for the creation of the John M. Bonner Memorial Home as part of a grand design or scheme to avoid estate, gift or income taxes; in 1905 no such taxes existed. There has been no manipulation by the taxpayers for their own gain or advantage. When it became apparent that the trust purpose had expired, the taxpayers exercised their rights under Louisiana law and sought a declaration of termination of the trust and a distribution of residual assets. The commissioner concedes that if the trustees had simply given prior notice of this intention there would be no basis for any tax payment or penalty. Notice after the distribution came too late, says the commissioner. So

says today's majority. In this particular case, in this particular setting, I would not say so. Under these peculiar facts, I would find the belated preregulation notice adequate.

I respectfully dissent.

(Entered November 5, 1985.)

## FOOTNOTES

*Circuit Judge of the Second Circuit, sitting by designation.

1 Unless otherwise stated, all statutory citations in this opinion are to sections of the Internal Revenue Code of 1954, as amended by the Tax Reform Act of 1969, Pub.L. No. 91-172, 83 Stat. 487 (1969) (the 1969 Act). The I.R.C. sections in turn correspond to sections of Title 26 of the United States Code, 1982 codification. For convenience, we shall abbreviate the citations by referring to sections of the Code, e.g., "§ 4945".

2 As we indicate later in this opinion, we are unwilling - because it is unnecessary - to resolve a conflict between the parties regarding this state court decision and a subsequent one. We do note what the Court of Appeal of Louisiana stated in Bonner, supra:

"Plaintiffs have no vested rights because they are not forced heirs and they were completely ignored in the decedent's testament.

. . . . . .

On the other hand, if the heirs should prevail, the Home would no longer exist ..., but would be promptly and permanently closed, and the remaining

assets of the Trust, though only sufficient to maintain it for a few more years, would escheat to the collateral heirs which the testatrix never intended."

Bonner v. Board of Trustees, supra, 181 So.2d at 258. Whether this language was dictum is an issue which we find is neither necessary nor appropriate for us to decide on the instant appeal.

3 It was stipulated in the Tax Court that this second state action was an adversary proceeding as between the parties represented. However, neither other homes for the aged - to which the assets could have been transferred - nor the State of Louisiana were represented.

4 The parties have since stipulated that the total fair market value of the transferred assets was $200,569. The Tax Court concluded that any transferee liability could not exceed this amount. Gladney v. Commissioner, 45 T.C.M. 280, 281 n. 2 (1982). We agree.

5 The petition filed by the Gladney heirs was consolidated with the one filed by the Bonner heirs for purposes of trial, briefs, and opinion in the Tax Court. The cases also were consolidated for purposes of this

appeal. Both cases arise out of the same facts and present identical legal issues. Unless otherwise stated, all references to "appellees", "taxpayers", "heirs", or "transferees" are collective.

Since the Bonner heirs resided in Maine when their petition was filed in the Tax Court (the Gladney heirs residing in Louisiana), normally venue for the Bonner appeal would lie in the First Circuit. Pursuant to § 7482(b)(2), the Commissioner and the Bonners stipulated to venue in the Fifth Circuit. Thus both appeals were consolidated in this Circuit. The consolidated appeal could have been brought in either the First or Fifth Circuit. We are grateful for small favors.

6 These statutory provisions regulate such organizations by imposing excise taxes on prohibited activities such as acts of self- dealing (§ 4941) and excess business holdings (§ 4943).

7. Section 4945 in relevant part provides:

"§ 4945. Taxes on taxable expenditures
(a) Initial taxes
(1) On the foundation
There is hereby imposed on each taxable expenditure (as defined in subsection (d)) a tax equal to 10 percent of the amount thereof.

The tax imposed by this paragraph shall be paid by the private foundation.

. . . . . .

(b) Additional taxes

(1) On the foundation

In any case in which an initial tax is imposed by subsection (a)(1) on a taxable expenditure and such expenditure is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount of the expenditure. The tax imposed by this paragraph shall be paid by the private foundation.

. . . . . .

(d) Taxable expenditure

For purposes of this section, the term "taxable expenditure" means any amount paid or incurred by a private foundation.

. . . . . .

(5) for any purpose other than one specified in section 170(c)(2)(B)."

8 Section 507 in relevant part provides:

"§ 507. Termination of private foundation status

(a) General rule
Except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if -
(1) such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination, or

. . . . . .

(c) Imposition of tax
There is hereby imposed on each organization which is referred to in subsection (a) a tax equal to the lower of -
(1) the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or (2) the value of the net assets of such foundation.

. . . . . .

(g) Abatement of taxes
The Secretary may abate the unpaid portion of the assessment of any tax imposed by subsection (c), or any liability in respect thereof, if -

> (1) the private foundation distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii) each of which has been in existence and so described for a continuous period of at least 60 calendar months, or
>
> (2) following the notification prescribed in section 6104(c) to the appropriate State officer, such State officer within one year notifies the Secretary, in such manner as the Secretary may by regulations prescribe, that corrective action has been initiated purusant to State law to insure that the assets of such private foundation are preserved for such charitable or other purposes specified in section 501(c)(3) as may be ordered or approved by a court of competent jurisdiction, and upon completion of the corrective action, the Secretary receives certification from the appropriate State officer that such action has resulted in such preservation of assets."

9 This was stipulated to by the parties.

10 Regulations under § 507(a) were not proposed until April 22, 1972 and were not adopted until December 21, 1972.

11 Congress simultaneously provided in § 508(e)(1) that, as a condition of tax exempt status, a private foundation must include in its charter a provision prohibiting it from committing any of the excise tax forbidden actions, such as the § 4945 taxable expenditures. In this regard, the House noted that it is important to have

> "vigorous enforcement of strong State laws by the State attorney general or other appropriate official. In order to encourage and facilitate effective State involvement, the bill provides as an additional condition of exemption for private foundations the requirement that the governing instrument require current distributions of income (sec. 4942) and prohibit self-dealing (sec. 4941), retention of excess business holdings (sec. 4943), speculative investments (sec. 4944), and taxable expenditures (sec. 4945). Existing private foundations are given time to modify their governing instruments. Your committee intends and expects that this requirement will add to the enforcement tools available to State officials charged with supervision of charitable organizations."

H.R.Rep. No. 413, supra, at 40, reprinted in 1969 U.S.Code Cong. & Ad.News at 1685.

12 As a practical matter, we can only suggest to future transferees in similar situations that they take a more active role in seeing that their private foundation-transferor comply with all state and federal regulations governing the transfer - including the Internal Revenue Code. In this instance, the heirs undertook fairly extensive litigation in state courts to establish a right to the assets. One wonders why their counsel did not invest a modest, additional amount of time to protect those assets from the inadventure of trustees who were winding down their responsibilities.

13 Section 4947(a)(2) provides:

"§ 4947. Application of taxes to certain nonexempt trusts
(a) Application of tax

. . . . . .

(2) Split-interest trusts
In the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interest in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and which has amounts in trust for which a deduction was allowed under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, section 507 (relating to termination of private foundation status), section 508(e)(relating to governing instruments)."

14 In view of this conclusion, we need not rule upon appellees' other argument in support of the applicability of § 4947(a)(2), namely, the affect, if any, that the 1971 state court judgment had on defining the legal status of the Home.

Likewise, in view of our conclusion above in Section II of this opinion - that the provisions of the 1969 Act and the Congressional intent in enacting it require a finding of § 4945 liability - we find it neither necessary nor appropriate to reach the Commissioner's argument that the 1971 state court judgment was erroneous.

15 The Jacobs Court stated:

"But the tax was not levied on the 1909 transfer [the creation of the joint tenancy] and was not retroactive. At decedent's death in 1924, ownership and beneficial rights in the property which had existed in both tenants jointly changed into the single ownership of the survivor. This change in ownership, attributable to the special character of joint tenancies, was made the occasion for an excise, to be measured by the value of the property in which the change of ownership occurred. Had the tenancy not been created, this survivorship and change of ownership would not have taken place, but the tax does not

operate retroactively merely because some of the facts or conditions upon which its application depends came into being prior to the enactment of the tax."

Id. at 366-67 (footnote omitted).

16 We re-emphasize that we refuse to resolve this issue of state law. In this section, as in Section II, we find it unnecessary to do so.

# APPENDIX C

## UNITED STATES COURT OF APPEALS
## FOR THE FIFTH CIRCUIT

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No. 83-4379

---

U.S. Tax Ct. No. 6355-77

WILLIAM F. BONNER, JR., ESTATE OF BETTINA BONNER, William F. Bonner, Jr., Executor, Transferees,

Appellees-Cross-Appellants

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellant

---

Appeal from the Decision of the
United States Tax Court

---

Before Timers*, Politz and Randall, Circuit Judges.

*Circuit judge of the Second Circuit, sitting by designation.

# JUDGMENT

This cause came on to be heard on the record on appeal and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the decision of the said Tax Court in this cause be, and the same is hereby, reversed; and that this cause be, and the same is hereby, remanded to the said Tax Court in accordance with the opinion of this Court;

IT IS FURTHER ORDERED that respondent-appellant pay to petitioners-appellees the costs on appeal, to be taxed by the Clerk of this Court.

November 5, 1984

POLITZ, Circuit Judge, dissenting.

ISSUED AS MANDATE:

## APPENDIX D

## IN THE UNITED STATES COURT OF APPEALS

## FOR THE FIFTH CIRCUIT

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No. 83-4229
83-4379

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WILLIAM KELLY GLADNEY,
EVELYN GLADNEY WITHERSPOON,
CELESTE GLADNEY PEERS,
JULIAN M. GLADNEY and
EDWARD LEE GLADNEY, Transferees,
Petitioners-Appellees,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

- - - - - - - - - - - - - -

On Appeal from the Decision of the
United States Tax Court

- - - - - - - - - - - - - -

Before TIMBERS*, POLITZ and RANDALL, Circuit Judges.

*Circuit Judge of the Second Circuit, sitting by designation.

PER CURIAM:

Treating the suggestion for rehearing en banc as a petition for panel rehearing, the petition for panel rehearing is DENIED. The judges in regular active service of this Court having been polled at the request of one of said judges and a majority of said judges not having voted in favor of it (Federal Rules of Appellate Procedure and Local Rule 35), the suggestion for Rehearing En Banc is DENIED.

Politz, J. dissents from the denial of rehearing and rehearing en banc for the reasons set forth in his dissent from the panel opinion.

ENTERED FOR THE COURT:

[Henry A. Politz]
United States Circuit Judge

Filed: February 15, 1985
Gilbert F. Ganucheau, Clerk
U.S. Court of Appeals

# APPENDIX E

T. C. Memo. 1982-708

UNITED STATES TAX COURT

WILLIAM KELLY GLADNEY, EVELYN GLADNEY WITHERSPOON, CELESTE GLADNEY PEERS, JULIAN M. GLADNEY, and EDWARD LEE GLADNEY, Transferees, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

WILLIAM F. BONNER, JR., ESTATE OF BETTINA BONNER, WILLIAM F. BONNER, JR., Executor, Transferee, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 6294-77, 6355-77.
Filed December 6, 1982

D died in 1905, bequeathing certain property in trust, the donee to be incorporated, to found and maintain a home for aged and infirm men. The donee organization was ruled tax-exempt by respondent in 1950. The number of residents at the home declined, its expenses increased, and part of the organization's capital was used to pay the resulting excess of expenses over income.

On July 1, 1971, the organization closed the home for financial reasons. On November 5, 1971, D's heirs, the petitioners in these cases, brought a declaratory judgment action to have the Louisiana Civil District Court order that

the organization be dissolved on the grounds that D's purpose could no longer be accomplished. In an adversary proceeding, that court held for the heirs and entered a judgment on December 23, 1971, ordering that the organization should be dissolved and that the heirs were entitled to the assets. No appeal from that judgment was taken. On January 18, 1972, and March 13, 1972, the organization delivered the remaining assets to the heirs.

The amount of the aggregate tax benefit (as defined in sec. 507(d), I.R.C. 1954) resulting form the organization's section 501(c)(3) status is zero.

Respondent determined deficiencies in private foundation excise taxes under section 4945, I.R.C. 1954, against the organization, and transferee liabilities against the heirs.

Held: Under the circumstances of these cases, the organization's private foundation status, if any, terminated before the transfers of assets to the heirs; no tax is imposed on the organization under section 4945, I.R.C. 1954; and so no transferee liability is imposed on the heirs.

Edward Lee Gladney, for the petitioners in docket No. 6294-77.

Charles B. Sklar and Robert T. Bowsher, for the petitioners in docket No. 6355-77.

William A. Neilson and Alan H. Kaufman, for the respondent.

## MEMORANDUM OPINION

CHABOT, Judge:* Respondent determined that petitioners are liable as transferees of the assets of the Board of Trustees of the John M. Bonner Memorial Home (hereinafter sometimes referred to as "the Board") for unpaid Federal excise taxes under section 4945[1], as follows:

| Docket No. | Petitioner | Transferee Liability |
|---|---|---|
| 6294-77 | William Kelly Gladney | $ 30,081.28 |
| | Evelyn Gladney Witherspoon | 30,081.28 |
| | Celeste Gladney Peers | 30,081.28 |
| | Julian M. Gladney | 30,081.28 |
| | Edward Lee Gladney | 30,081.28 |
| 6355-77 | William F. Bonner, Jr. | 30,081.28 |
| | Estate of Bettina Bonner, William F. Bonner, Jr., Executor | 30,081.28 |
| | | $210,568.96[2] |

These cases have been consolidated for trial, briefs, and opinion. The principal issue for decision is whether the Board is liable for excise taxes under section 4945.

These cases have been submitted fully stipulated; the stipulations and the stipulated exhibits are incorporated herein by this reference.

When the petition in docket no. 6294-77 was filed, all the petitioners in

this docket resided in Louisiana. When the petition in docket no. 6355-77 was filed, both of the petitioners in this docket resided in Maine. (The individual petitioners in both dockets, and Bettina Bonner (the decedent of the estate petitioner in docket no. 6355-77) are hereinafter sometimes collectively referred to as "the Heirs".)

Lelia Bonner Dwyer (hereinafter sometimes referred to as "Dwyer") died testate on June 22, 1905. After directing several specific bequests, her will (dated July 16, 1901) containing the following provisions:

> Third. I desire all my real estate, except the residence and lots situated in the square bounded by First, Second, Coliseum and Chestnut Streets in the City of New Orleans, to be sold by my executor to the best advantage, and after the payment of the foregoing special pecuniary legacies, which are expressly charged upon said real

estate so to be sold, and are not to bear upon any other portion of my estate, I will and bequeath all the rest and residue of the proceeds of said real estate so to be sold, to Alexander J. Dwyer, Alfred LeBlanc, Joseph W. Carroll, William B. Sommerville, Joseph P. Blair, Benjamin Moss all of New Orleans, Louisiana, as trustees in trust to found and maintain in New Orleans a Home for Aged and Infirm Men to be called the John M. Bonner Memorial Home, and I request said trustees to form themselves into a body corporate under the laws of the State of Louisiana, to carry this trust into effect. I desire said corporation to be formed pursuant to the provisions of Act 124 of the acts of the legislature of Louisiana of the year 1882, and I desire that vacancies in the Board of Trustees be filled by election by the remaining trustees.

Fourth. I name and constitute my beloved husband Alexander J. Dwyer as my universal residuary legatee, and give and bequeath to him all property of every nature whatsoever of which I may die possessed other than that hereinbefore specially bequeathed and expressly including in the property so given and bequeathed to my said husband the residence and lots being all the real estate owned by me in the square bounded by First, Second,

Coliseum and Chestnut Streets, in
the City of New Orleans.

Dwyer's husband, Alexander J. Dwyer (referred to in paragraphs Third and Fourth of Dwyer's will, supra) predeceased her.

On or about June 27, 1905, Dwyer's six then-surviving first cousins petitioned the Louisiana Civil District Court in which Dwyer's will was probated to recognize them as Dwyer's sole heirs and put them into possession of all property left by her after payment of the specific bequests in her will. On June 28, 1905, the Louisiana Civil District Court rendered a judgment in open court recognizing those six cousins as Dwyer's sole heirs at law and putting them in possession of such property (each to receive an undivided one-sixth portion of such property after payment of state legacy taxes.)

On July 13, 1905, the surviving

Trustees[3] under paragraph Third of Dwyer's will formed the Board as a corporation for the purpose of carrying into effect thge trust imposed on the Trustees by Dwyer's will (see paragraph Third, _supra_).[4] Article III of the Board's charter provides as follows:

> The objects, purposes and powers of this corportation are hereby declared to be: To carry into effect the trust created and imposed by the said will of Mrs. Lelia Bonner Dwyer; to accept and administer [sic] the property entrusted to said Trustees [sic] in conformity with said act of donation, and to have and exercise all the power needed in such administration; to accept and administer other donations _mortis causa_ or _inter vivos_ from other donors, and to apply the same as may be prescribed in any subsequent act of donation; to receive, buy, sell, mortgage and pledge property, movable and immovable, in accordance with law, and generally to have and exercise any and all the powers conferred by the laws of this State upon corporations organized for literary, scientific,

> religious and charitable purposes, including the power to make and use a corporate seal and the same to break or alter at pleasure, and, under its said corporate name, to contract, sue and be sued; and to make and establish, as well as to alter and amend from time to time, such rules, by-laws and ordinances for the property conduct, management and regulation of its affairs as may be necessary and proper.

In 1906, the Board recieved real property, an undivided interests in real property that had belonged to Dwyer.

From 1907 through 1914, the Board sold some real estate and acquired property in New Orleans, Louisiana, on which it intended to construct a building as a home for aged and infirm men, in accordance with paragraph Third of Dwyer's will. Construction of the building was completed in 1915. The building, named the "John M. Bonner Memorial Home" (hereinafter referred to as "the Home"), was dedicated and opened on June 9, 1915.

In conformance with Dwyer's stated purpose, the Home operated at a capacity of about 20 men until the early 1950's. During the 1950's the number of residents of the Home began to decrease, and its annual operating expenses began to exceed yearly income, causing it to begin using part of its capital to pay operating expenses.

An exemption affidavit (Treasury Dept. Form 1023), dated June 22, 1950, was filed with the Internal Revenue Service on behalf of the Board requesting an exemption from Federal income taxes under section 101(6) of the Internal Revenue Code of 1939 (predecessor of sec. 501(c)(3) of the Internal Revenue Code of 1954). Qu-stion 16 on the Form 1023 asked: "In the event of the dissolution of the organization, what disposition would be made of its property?" This question was answered as

follows:

> 16. The members of the Board of Trustees have no right or power to dissolve this corporation. If they fail to perform their functions the court would appoint new Trustees in their places. If the Corporation were dissolved it is uncertain, under the laws of Louisiana, what dispositon would be made of this property, but it is clear that no part thereof would accrue to any of the then or previous trustees.

By letter, dated July 26, 1950, the Internal Revenue Service notified the Board as follows:

> It is the opinion of this office, based upon the evidence presented, that you are exempt from Federal income tax under the provisions of section 101(6) of the Internal Revenue Code and corresponding provisions of prior revenue acts, as it is shown that you are organized and operated exclusively for charitable purposes.

At a special meeting of the Trustees on February 29, 1956, the following business transpired:

> Mr. McIlhenny read to the [Trustees] the requirements of the State Fire Marshal and the State Board of Health, requiring various changes and additions to the present building. After which the President suggested that we hold a meeting at the Home with the State and City Authorities and discuss the situation with them.
>
> * * *
>
> Discussion was had as to whether it would not be preferable to close the Home and find another place for the present inmates than to expend large sums of money to make the major additions required by the governing authorities. No formal action was taken at this meeting on this matter.

In 1963 Dwyer's surviving collateral heirs sued the Trustees in the Louisiana Civil District Court, asserting that the trust should be dissolved and the remaining

assets delivered to them, on the grounds that Dwyer's testamentary trust had been completely fullfilled and could not be further performed. The District Court entered judgment in favor of the Trustees and against the heirs, from which the heirs appealed. The Fourth Circuit Court of Appeal of Louisiana affirmed the District Court. Bonner v. Board of Trustees, 181 So.2d 255 (La. App. 1965), writ refused 248 La. 915, 182 So.2d 664 (1966). The court of Appeal concluded its opinion as follows (181 So.2d at 258):

> (1) Even though only five men are being maintained by the Home at the present time, and substantial repairs should be made to the Home, the heirs have a right only to submit an alternate plan as to how the general purpose of the Trust can be better accomplished.
>
> (2) Plaintiffs contend that LSA-R.S. 9:2331-37, Part IV verbo "Cy Pres" under the subject "Charitable, Etc., Trusts," is

unconstitutional because it is an ex post facto statute destroying their vested rights as heirs of the deceased. This contention is untenable because:

(1) The statute is not ex post facto because it merely establishes a procedure to follow in pursuit of the existing cy pres or approximation doctrine already existing in Louisiana as clearly stated in In re Milne's Succession, cited supra.

(2) Plaintiffs have no vested rights because they are not forced heirs and they were completely ignored in the decedent's testament.

The Cy Pres statute was interpreted in In re Succession of Abraham, 136 So.2d 471 (La. App. 1962) to the effect that, where the circumstances have so changed since the creation of a Trust as to render it impractical or impossible to comply literally with the terms thereof, the court may decree that the donation be administered in such a manner as to accomplish, as nearly as possible under the then existing circumstances, the general purpose of the bequest or donation.

We fully agree with the district court that the Trustees are reasonably carrying out the purpose of the Trust, as the Home is still in existence, in reasonable

> condition as shown by the photographs, and funds are available to take care of elderly men at this time, even though the number now carred for is only five. On the other hand, if the heirs should prevail, the Home would no longer exist to care for aged men however few, nor as a memorial to John M. Bonner, but would be promptly and permanently closed, and the remaining assets of the Trust, though only sufficient to maintain it for a few more years, would escheat to the collateral heirs which the testatrix never intended.
>
> The judgment of the district court is correct and is affirmed; Plaintiffs to pay costs in both courts.
>
> Judgment affirmed.

In 1970 the Internal Revenue Service sent the Board a form letter transmitting a Form 4653 (Notificaton Concerning Foundation Status) and Instructions regarding status and classification as a private foundation because of provisions of the Tax Reform Act of 1969. By letter dated August 21, 1970, the Trustees forwarded the completed Form 4653 to the Internal Revenue

Service, stating that the Board was a private foundation within the meaning of section 509(a) and claiming that it was an operating foundation within the meaning of section 4942(j)(3).

On July 1, 1971, the Trustees closed the Home, which at that time had only two residents, because its cost of operating had significantly exceeded the revenues of the trust fund. As operating costs increased, the revenues available for maintenance of the Home were being substantially depleted.

A form letter dated July 9, 1971, sent to the Board by the Internal Revenue Service, stated that the Internal Revenue Service was waiting for the promulgation of Treasury Regulations pertaining to section 509 before it would respond to the form 4653 submitted by the Trustees. A form letter dated October 5, 1971, sent to the Board by the Chief of the rulings Section

of the Exempt Organizations Branch, stated that the Board had been classified as a private foundation as defined in section 509(a) and as an operating foundation as defined in section 4942(j)(3).

On November 5, 1971, the Heirs filed a petition in a declaratory judgment proceeding in the Louisiana Civil District Court, asking that "the donation of [Dwyer] made for the purpose of establishing and maintaining the [Home] be dissolved on account of the non-performance of the conditions imposed by the donor on the donee", that they be declared Dwyer's heirs at law, and that they be declared to be entitled to the remaining assets donated by Dwyer. The defendant Trustees answered, asserting that the Home had been closed, that "it is impractical to continue the trust and that, in fact, the trust established by Mrs. Dwyer in 1905 has been

satisfactorily fulfilled." The Trustees' answer stated that, of the 16 other homes for aged people in the community, 10 accepted both men and women, 6 accepted women only, and none precisely fit the pattern of the Home. They stated that "the Trustees leave to the judgment of this Honorable Court the decision as to whether or not the remaining trust assets should be delivered to the heris of Mrs. Dwyer or diverted to another cause."

The Trustees' sole argument at the 1971 trial, presented orally by their attorney, was that the cy pres doctrine should be applied to the facts of the case. This position was opposed by the Heirs. The litigation was an adversary proceeding.[5] The District Court Judge orally assigned reasons for his decision and on December 23, 1971, entered the following judgment:

# JUDGMENT

* * *

IT IS ORDERED, ADJUDGED AND DECREED that there be judgment herein in favor of plaintiffs' declaring:

That the donation of Lelia Bonner Dwyer made for the purpose of establishing and maintaining the John M. Bonner Memorial Home be dissolved since the trust has been completely fulfilled and cannot be further performed; and that William F. Bonner, Jr., Bettina Bonner, Mrs. Evelyn Gladney, widow of Jackson Thornwell Witherspoon, Jr., Mrs. Celeste Gladney, divorced wife of William A. Shell, now widow of George Peers, William Kelly Gladney, Julian M. Gladney and Edward Lee Gladney, to be the heirs at law of Lelia Bonner Dwyer, and as such entitled in equal portions to the remaining assets of said donations including all property of every description, real, peronal [sic] and mixed.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant make a prompt and full accounting as provided by law and that delivery of the properties to plaintiffs' [sic] be made with the formalities provided by law.* * *

One of the Trustees (the one who made the statement described in n. 5, supra) concluded and recommended to the Trustees that the December 23, 1971, judgment of the District Court was based on a factual determination and, accordingly, that there was no basis for an appeal. Consequently, on January 18, 1972, and on March 13, 1972, the Trustees delivered to the Heirs the remaining assets of the Board. These assets were divided equally among the Heirs.

After the delivery of all of the Board's remaining assets to the Heirs, the Board was without other assets and carried on only minimum ministerial functions.

A Form 966-E (Liquidation, Dissolution, Termination or Substantial Contraction of Organizations Exempt or Formerly Exempt under Section 501(a)), dated October 24, 1973, was filed on behalf

of the Board with the Internal Revenue Service, stating that the Board had been dissolved and that final distribution of assets had been made on January 18, 1972. A Form 990 (Return of Organization Exempt From Income Tax), dated October 24, 1973, and labelled "Final Return," was filed for 1972 on behalf of the Board with the Internal Revenue Service. A Form 990-AR (Annual Report of Private Foundation), dated February 7, 1974, was filed for 1972 on behalf of the Board with the Internal Revenue Service, stating that the assets of the Board had been delivered to the Heirs by order of the Louisiana Civil District Court as of January 18, 1972.

There were no contributions by substantial contributors (as defined in sec. 507(d)(2)) made to the Board after February 28, 1913, and no contributions by anyone made to the Board after May 26, 4

1969. If the Board had taxable income in any year ending after February 28, 1913, then any such taxable income was completely offset by net operating losses which would properly be carried over to that taxable year. The amount of the aggregate tax benefit as defined in section 507(d)[6] resulting from the Board's section 501(c)(3) status is zero.

Respondent maintains that the Board's distributions of its assets to the Heirs are "taxable expenditures" under section 4945[7] because the distributions were made "for purposes other than expressed in section 170(c)(2)(B)"[8], that these taxable expenditures gave rise to liabilities of the Board for excise taxes under section 4945, and that petitioners are liable for these taxes as transferees of the assets of the Board.

Petitioners argue[9] that under Louisiana law Dwyer's heirs had a right of reversion in the trust assets, the existence of which precludes classification of the Board as a private foundation and makes it a split-interest trust under section 4947(a)(2) the assets of which were placed in trust before May 27, 1969. From this, they argue that the transfer of assets to the Heirs is not subject to section 4945. Alternatively, they contend that respondent has failed to bear his burden of providing that petitioners are transferees of assets with the meaning of section 6901. Also in the alternative, petitioners maintain that application of section 4945 in the instant case is beyond the purpose of Congress in enacting this section or would result in denial of their rights to property without due process of

law, in violation of the Fifth Amendment to the United States Constitution (as constituting retroactive application of section 4945 to their vested property rights).

As another alternative, petitioners contend that the 1971 order of the Louisiana Civil District Court acted to terminate the Board as a private foundation for purposes of sections 507 and 509, the transfer of trust assets occurred on termination as was not subject to the section 4945 tax and there is no tax under section 507(c) because the amount of the aggregate tax benefit under section 507(d) is zero.

Respondent replies that there was no right of reversion under Louisiana law, the 1971 judgment of the Louisiana Civil District Court was erroneous and should not be given any effect, and the Board was a

private foundation, the transfer of assets from which was subject to section 4945. He also contends that the amount of tax imposed by sections 4945(a)(1) or 4945(b)(1) is not limited to the amount of the aggregate tax benefit as defined in section 507(d).

We agree with petitioners' contention that the Board has no tax liability and that, therefore, petitioners have no transferee liability.

Section 4945 was enacted by Section 101 of the Tax Reform Act of 1969 (hereinafter sometimes referred to as "TRA 69"), Pub. L. 91-172, 83 Stat. 512. A recurrent theme in the legislative history makes it clear that, in enacting section 101, TRA 69, the Congress was dissatisfied with then-existing law in that (1) it appeared to permit many activities that were thought to be abuses of the tax

benefits enjoyed by private foundations and their donors, and (2) the only sanction for violation under then-present law was future loss of status as a section 501(c)(3) exempt organization and as an eligible donee for deductible charitable contributions. The Congress believed that these sanctions often were either too harsh or too trivial[10].

Accordingly, in section 101, TRA 69, the Congress provided an arsenal of provisions intended to reduce the likelihood of misuse of the tax benefits available to private foundations and to those that contribute to these organizations. Section 101, TRA 69, includes a series of detailed standards of conduct, a series of sanctions intended to be more appropriately related to the violations (and more practical to enforce) than prior law, and a series of publicity and disclosure provisions

intended to assist in oversight of foundations by the public and by state officials, as well as by the Internal Revenue Service. At the head of these provisions (in fact, as the first substantive provision in the entire TRA 69, 83 Stat. 492), the Congress set section 507[11], which provides that an organization could escape private foundation status--in particular, the newly-enacted restrictions and sanctions--but only if the organization pays a tax equal to the amount of the tax benefits (plus interest) that it and its substantial contributors had enjoyed because of the organization's section 501(c)(3) status[12].

Thus, the Congress made it clear that the imposition of the standards, sanctions, and procedural rules was a quid pro quo for the tax benefits, including interest, to the private foundation and its substantial contributors.

In the instant cases, the parties have stipulated that these aggregate tax benefits were zero.

At the time the District Court judgment was entered and the Board determined not to appeal, (1) the Board's charitable operation had been closed down for about six months, (2) the Board's section 507(c) tax was zero, and (3) respondent had not taken any public position in furtherance of his statutory obligaton under section 507(a)(1) to prescribe by regulations the time and manner in which an organization was to notify respondent of an intention to terminate its private foundations status.

Regulations under section 507(a) were not proposed until April 22, 1972 (37 Fed. Reg. 7986)[13], and not adopted until December 21, 1972 (T.D. 7233, 37 Fed. Reg. 28157, 1973-1, C.B. 235)[14]. In October

1973, the Board filed with the Internal Revenue Service its Form 966-E (Liquidation, Dissolution, Temination or Substantial Contraction of Organizations Exempt or Formerly Exempt under Section 501(a)) and also its Form 990 (Return of Organization Exempt From Income Tax), both of which indicated that the Board had dissolved.

The statute itself does not define the event that constitutes a termination nor does it provide for either the time or manner of notification.

We conclude that, under the circumstances of the instant cases, the Board's private foundation status (if any) was terminated under section 507(a)(1) on the entry of the unappealed judgment of the District Court, on December 23, 1971, and that the subsequent transfers of assets in accordance with this judgment did not give rise to taxes under section 4945.

Since we conclude that the 1972 transfers of assets did not give rise to the section 4945 taxes determined by respondent, petitioners have no liabilities as transferees.

We believe that this conclusion is consistent with the Congress' clear policy of imposing regulatory-type burdens in exchange for tax benefits, as described supra. We believe that respondent has been given ample authority under section 507(a)(1) to establish procedures to protect the integrity of the statutory scheme; we see no need to determine precisely what the existing regulations require, expecially as to the time of notification of intent to teminate[15]. See Gottesman & Co. v. Commissioner, 77 T.C. 1149, 1157-1158 (1981); Corn Belt Hatcheries of Arkansas, Inc. v. Commissioner, 52 T.C. 636, 639-640 (1969).

Under the state of the law and the factual situation as of the end of 1971, we conclude that the notification requirement was satisfied by the subsequent filings by the Board, stating that it had been dissolved and that final distributions of assets had been made.

In light of these conclusions, we see no need to determine what constitutes "proper regard" for the unappealed 1971 Louisiana Civil District Court ruling that the Heirs had a right of reversion in the Boards assets (Commissioner v. Estate of Bosch, 387 U.S. 456, 465 (1967))[16]; what sort of notification might have been required if the Board's aggregate tax benefits had been greater than zero; whether the Board was a private foundation (sec. 509(a)) or a split-interest trust (sec. 4947(a)(2)); and what the nature is of respondent's burden of proving that the

transfers here in dispute are the sort that could give rise to transferee liability (sec. 6902(a))

We hold for petitioners.

Decisions will be entered for petitioners.

## FOOTNOTES

[1] Unless indicated otherwise, all section references are to sections of the Internal Revenue Code of 1954 as in effect at the times of the events in issue.

Respondent determined deficiencies in Federal excise taxes against the Board as follows: (1) under section 4945(a)(1) in the amount of $21,056.90; and (2) under section 4945(b)(1) in the amount of $210,569.

[2] The parties have stipulated that the total fair market value of the transferred assets was $200,569. Since transferee liability is not to exceed the amount transferred (*Yagoda v. Commissioner*, 39 T.C. 170, 185-186 (1962), affd. 331 F.2d 485 (CA2 1964), the aggregate of any transferee liabilities is not to exceed $200,569. Since the assets were divided equally among the seven recipients, any transferee liability of any petitioner is not to exceed one-seventh of this total, or $28,652.71.

[3] As noted *supra*, Alexander J. Dwyer had predeceased Dwyer. Also, in order to avoid expense and confusion the remaining trustees elected Walter B. Sommerville as a trustee, he apparently being the individual intended by Dwyer's holographic will's reference to "William B. Sommerville".

When the term "the Trustees" is hereinafter used with regard to a specified time, this term refers collectively to the

members of the Board of Trustees as of that time.

4 The parties frequently refer to the Board as a trust, even though they have stipulated that the Board was incorporated. It appears that the Board held the assets in order to carry out a trust that had been impressed on the assets by Dwyer's will. However, this is frequently the case with incorporated charities. In any event, none of the parties contends that our resolution of the dispute before us is affected by whether the Board is classified as a trust or a corporation.

5 The parties have so stipulated. At a September 22, 1971, special meeting of the Trustees, one of the Trustees stated that he felt no moral obligation to find a specific institution to which the assets should go, and no desire to deprive the Heirs of the assets.

6

SEC. 507. TERMINATION OF PRIVATE FOUNDATION STATUS.

* * *

(d) Aggregate Tax Benefit.--

(1) In General.--For purposes of subsection (c), the aggregate tax benefit resulting from the section 501(c)(3) status of any private foundation is the sum of--

(A) the aggregate increases in tax under chapters 1, 11, and 12 (or the corresponding provisions of prior law) which

would have been imposed with respect to all substantial contributors to the foundation if deductions for all contributions made by such contributors to the foundation after February 28, 1913, had been disallowed, and

(B) the aggregate increases in tax under chapter 1 (or the corresponding provisions of prior law) which would have been imposed with respect to the income of the private foundation for taxable years beginning after December 31, 1912, if (i) it had not been exempt from tax under section 501(a) (or the corresponding provisions of prior law), and (ii) in the case of a trust, deductions under section 642(c) (or the corresponding provisions of prior law) had been limited to 20 percent of the taxable income of the trust (computed without the benefit of section 642(c) but with the benefit of section 170(b)(1)(A)), and

(C) interest on the increases in tax determined under subparagraphs (A) and (B) from the first date on which such increase would have been due and payable to the date on which the organization ceases to be a private foundation.

(2) Substantial Contributor.--

(A) Definition.--For purposes of paragraph (1), the term

"substantial contributor" means any person who contributed or bequeathed an aggregate amount of more than $5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. In the case of a trust, the term "substantial contributor" also means the creator of the trust.

(B) Special Rules.--For purposes of subparagraph (A)--

(i) each contribution or bequest shall be valued at fair market value on the date it was received,

(ii) in the case of a foundation which is in existence on October 9, 1969, all contributions and bequests received on or before such date shall be treated (except for purposes of clause (i)) as if received on such date,

(iii) an individual shall be treated as making all contributions and bequests made by his spouse, and

(iv) any person who is a substantial contributor on any date shall remain a

substantial contributor for all subsequent periods.

(3) Regulations.--For purposes of this section, the determination as to whether and to what extent there would have been any increase in tax shall be made in accordance with regulations prescribed by the Secretary or his delegate.

[The subsequent explicit and implied amendments of paragraphs (3) and (2), by section 1906(b)(13)[sic](A) of the Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1834, and section 3 of Pub. L. 95-170, 91 Stat. 1352, respectively, do not affect the instant cases.]

7

Section 4945 provides, in relevant part, as follows:

SEC. 4945. TAXES ON TAXABLE EXPENDITURES.

(a) Initial Taxes.--

(1) On the foundation.--There is hereby imposed on each taxable expenditure (as defined in subsection (d)) a tax equal to 10 percent of the amount thereof.

* * *

(b) Additional Taxes.--

(1) On the foundation.--In any case in which an initial tax is imposed by subsection (a)(1) on a taxable expenditure and such expenditure is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount of the expenditure.

* * *

(d) Taxable Expenditure.--For purposes of this section, the term "taxable expenditure" means any amount paid or incurred by a private foundation--

* * *

(5) for any purpose other than one specified in section 170(c)(2)(B).

[The amendment of section 4945(b)(1) by section 2(a)(1)(F) of Pub. L. 96-596, 94 Stat. 3469, although enacted in 1980, applies to "second-tier taxes" (such as those under sec. 4945(b)) assessed after the date of enactment, including those where the taxable event occurred before the date of enactment.]

8

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

* * *

(c) Charitable Contribution Defined.--For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of--

* * *

(2) A corporation, trust, or community chest, fund, or foundation--

* * *

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals;

[The subsequent amendment of this provision by section 1313(b)(1) of the Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1730, does not affect the instant cases.]

9

Petitioners in each docket are represented by different counsel who filed separate briefs. Since the interests of all petitioners appear to be identical, we treat contentions in any of petitioners' briefs as applying to all petitioners in the instant cases.

10

See, for example, the following excerpts from the report of the Senate Finance Committee on H.R. 13270, TRA 69:

> The sanctions provided [under pre-TRA 69 law] are loss of exemption for a minimum of one taxable year, and loss of charitable contributions deductions under certain circumstances.
>
> * * *
>
> On occasion sanctions are ineffective and tend to discourage the expenditure of enforcement effort. On the other hand, in many cases the sanctions are so great, in comparison to the offense involved, that they cause reluctance in enforcement, especially in view of the element of subjectivity in applying arm's-length standards. Where the Internal Revenue Service does not seek to apply sanctions in such circumstances, the same factors encourage extensive litigation and a noticeable reluctance by the courts to uphold severe sanctions.
>
> Therefore, as a practical matter, current law has not preserved the integrity of private foundations, even where the terms of the law apply.

* * *

They [the House Bill and the Senate Finance Committee's amendments] also provide for a graduated series of sanctions against the self-dealer and against a foundation manager who willfully engages in self-dealing. In the case of willful repeated acts or a willful and flagrant act, the Internal Revenue Service can require the foundation either to pay back to the Government the income, estate and gift tax benefits (with interest) which the foundation and all its substantial contributors had received or can require the foundation to distribute all its assets to a public charity or operate as a public charity itself.

* * *

In other cases, even though income is produced by the assets contributed to charitable organizations, no current distribution is required until the accumulations become "unreasonable." Although a number of court cases have begun to set guidelines as to the circumstances under which an accumulation becomes unreasonable, in many cases the determination is essentially subjective. Moreover, as is the case with self-dealing, it frequently happens that the only available sanction (loss of exempt status) either is largely ineffective or else is unduly harsh.

* * *

Present law.--Present law [i.e., in 1969] does not deal directly with foundation ownership of business

interests, although some cases have held that business involvement can become so great as to result in loss of exempt status.

General reasons for change.--The use of foundations to maintain control of businesses appears to be increasing. It is unclear under present law at what point such noncharitable purposes become suficiently great to disqualify the foundation from exempt status. Moreover, the loss of exempt status is a harsh sanction for having such holdings.

* * *

Under present law [i.e., in 1969] a private foundation manager may invest the assets (other than accumulated income) in warrants, commodity futures, and options, or may purchase on margin or otherwise risk the corpus of the foundation without being subject to sanction. (In one case a court held that the consistent practice of making such investments constituted operation of the foundation for a substantial non-exempt purpose and would result in loss of tax exemption.)

The committee agrees with the House that the same reasoning should apply to investments which jeopardize the foundation's corpus. Here, as in other sections, the committee also concluded that limited sanctions were preferable to the loss of exemption.

* * *

> If [under pre-TRA 69 law] an organization does not continue to meet the requirements for exemption, if it commits certain specifically prohibited acts (sec. 503), or if it deals in certain prohibited ways with its accumulated earnings (sec. 504), it loses its exempt status. This loss of exempt status may relate back to the time the organization first violated the code's requirements. However, if the violation occurred after the contributions had been made to the organization, no deductions are disallowed to such contributors. Also, the organization's income tax exemption is not disturbed for years before the organization's first violation.
>
> * * *
>
> In addition, they [the House of Representatives and the Senate Finance Committee] are concerned that in many cases under existing law the loss of exempt status will impose only a light burden on many existing foundations. This is true in those circumstances, for example, where the foundation has already received sufficient charitable contributions to provide its endowment and where the foundation could retain its exemption as to its current income by qualifying for exemption under an exemption category other than section 501(c)(3).

[S. Rept. 91-552 at 28, 29, 35, 38, 45, 53-54, 1969-3 C.B. 423, 442, 443, 446-447, 449, 453, 458, 459. To the same general

effect are H. Rept. 91-413 (Part 1) at 20, 21, 25, 27, 31, 37-38, 1969-3 C.B. 200, 214, 217, 218, 220, 224-225; and General Explanation of the Tax Reform Act of 1969, Staff of the Joint Committee on Internal Revenue Taxation, at 30, 31, 36, 40, 46, 54-55.]

11

Section 507 provides, in relevant part (see n. 6, _supra_, for the text of sec. 507(d)), as follows:

SEC. 507. TERMINATION OF PRIVATE FOUNDATION STATUS.

(a) General Rule.--Except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if--

> (1) such organization notifies the Secretary or his delegate (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) of its intent to accomplish such termination, or
>
> (2) (A) with respect to such organization, there have been either willful repeated acts (or failure to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42,and
>
> (B) the Secretary or his delegate notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c),

and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the

entire amount of such tax is abated under subsection (g).

* * *

(c) Imposition of Tax.--There is hereby imposed on each organization which is referred to in subsection (a) a tax equal to the lower of--

> (1) the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or
>
> (2) the value of the net assets of such foundation.

[The subsequent amendments of subsection (a) by section 1906(b)(13)[sic](A) of the Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1834, do not affect the instant cases.]

12

See, for example, the following excerpts from the portion headed "Change of Status" of the report of the Senate Finance Committee on H.R. 13270, TRA 69:

> If an organization wishes to avoid the limitations imposed upon private foundations, or if an organization persistently violates these limitations, however, it must repay all the tax benefits that it and its substantial contributors have received.
>
> * * *
>
> The committee agrees with the House that foundations should not

receive substantial and continuing tax benefits in exchange for te promise of use of the assets involved for educational, charitable, religious, etc., purposes but avoid the carrying out of these responsibilities. Accordingly, the bill provides that an organization which was a private foundation for its last taxable year ending before October 9, 1969, may not change its status unless it repays to the government the aggregate tax benefits (with interest) which have resulted from its exempt status.

* * *

The tax benefits to be repaid in such a case are all of the increases in income, estate, and gift taxes which would have been imposed upon the organization and all substantial contributors if the organization had been liable for income taxes and if its contributors had not received deductions for contributions to the organization. If the foundation is a trust, then the foundation's own income tax benefit is the amount by which its income taxes were reduced because it was permitted to deduct charitable contributions in excess of 20 percent of its taxable income. For purposes of computing the amount of the aggregate tax benefits, all benefits available to the private foundation for taxable years beginning after December 31, 1912, and all tax benefits on contributions made to the foundation after February 28, 1913, are included. In addition, interest

> on all such benefits is to be added to the amount of the benefits computed, in the case of each benefit, from the first date on which the added tax would have been due if the benefit had not been available. [Fn. reference omitted.]

[S. Rept. 91-552 at 54, 55, 1969-3 C.B. 423, 459-460. To the same effect are H. Rept. 91-413 (Part 1) at 38, 39, 1969-3 C.B. 200, 225-226; and General Explanation of the Tax Reform Act of 1969, Staff of the Joint Committee on Internal Revenue Taxation, at 55, 56.]

13

The only section 507 regulations that had been published even in proposed form before the proposed section 507(a) regulations were those relating to termination under section 507(b) (relating to transfer to, or operation as, a public charity) and definition of substantial contributor (a term that is of critical importance in the application of secs. 4941 and 4943, among others). Neither of these regulations afforded a guide to what was required in order to terminate under section 507(a)(1).

14

Section 1.507-1(b), Income Tax Regulations, provides, in pertinent part, as follows:

> Sec. 1.507-1. Private Foundations.
>
> * * *

(b) Termination under section 507(a)(1). (1) In order to terminate its private foundation status under paragraph (a)(1) of this section, an organization must submit a statement to the district director of its intent to terminate its private foundation status under section 507(a)(1). Such statement must set forth in detail the computation and amount of tax imposed under section 507(c). Unless the organization requests abatement of such tax pursuant to section 507(g), full payment of such tax must be made at the time the statement is filed under section 507(a)(1). An organization may request the abatement of all of the tax imposed under section 507(c), or may pay any part thereof and request abatement of the unpaid portion of the amount of tax assessed. If the organization requests abatement of the tax imposed under section 507(c) and such request is denied, the organization must pay such tax in full upon notification by the Internal Revenue Service that such tax will not be abated. For purposes of subtitle F of the Code, the statement described in this subparagraph, once filed, shall be treated as a return.

(2) Termination of private foundation status under section 507(a)(1) does not relieve a private foundation or any disqualified person with respect thereto, of liability for tax under chapter 42 with respect to

acts or failures to act prior to termination or for any additional taxes imposed for failure to correct such acts or failures to act. See subparagraph (8) of this paragraph as to the possible imposition of transferee liability in cases not involving termination of private foundation status.

* * *

(7) Neither a transfer of all of the assets of a private foundation nor a significant disposition of assets (as defined in sec. 1.507-3(c)(2)) by a private foundation (whether or not any portion of such significant disposition of assets is made to another private foundation) shall be deemed to result in a termination of the transferor private foundation under section 507(a) unless the transferor private foundation elects to terminate pursuant to section 507(a)(1) or section 507(a)(2) is applicable. Thus, if a private foundation transfers all of its assets to one or more persons, but less than all of its net assets to one or more organizations described in section 509(a)(1) which have been in existence and so described for a continuous period of 60 calendar months, for purposes of this paragraph such transferor foundation will not be deemed by reason of such transfer to have terminated its private foundation status under section 507(a) or (b) unless section 507(a)(2) is applicable. Such foundation will

continue to be treated as a private foundation for all purposes. For example, if a private foundation transfers all of its net assets to a section 509(a)(2) organization in 1971 and receives a bequest in 1973, the bequest will be regarded as having been made to a private foundation and the foundation will be subject to the provisions of chapter 42 with respect to such funds. If a private foundation makes a transfer of all of its net assets to a section 509(a)(2) or (3) organization, for example, it must retain sufficient income or assets to pay the tax imposed under section 4940 for that portion of its taxable year prior to such transfer. For additional rules applicable to a transfer by a private foundation of all of its net assets to a section 509(a)(1) organization which has not been in existence and so described for a continuous period of 60 calendar months, see sec. 1.507-3(e).

(8) If a private foundation makes a transfer described in subparagraph (7) of this paragraph and prior to, or in connection with, such transfer, liability for any tax under chapter 42 is incurred by the transferor foundation, transferee liability may be applied against the transferee organization for payment of such taxes. For purposes of this subparagraph, liability for any tax imposed under chapter 42 for failure to correct any act or failure to act shall be deemed incurred on the date

on which the act or failure to act giving rise to the initial tax liability occurred.

(9) A private foundation which transfers all of its net assets is required to file Form 990, Annual Information Return, and the foundation managers are required to file Form 990-AR, Annual Report of Private Foundation, or the equivalent thereof, for the taxable year in which such transfer occurs. However, neither such foundation nor its foundation managers will be required to file such forms for any taxable year following the taxable year in which the last of any such transfers occurred, if at no time during the subsequent taxable years in question the foundation has either legal or equitable title to any assets or engages in any activity.

* * *

15

Respondent suggests that a timing requirement may be extracted from section 1.507-7, Income Tax Regs. We note that this particular regulation appears to be concerned with rules for valuation of net assets, a matter whose statutory significance appears to be limited to (1) situations where the aggregate tax benefit exceeds the value of the organization's net assets and (2) situations where the organization seeks to terminate its status under section 507(b). In the instant cases, the aggregate tax benefit is zero (and so the value of the net assets is irrelevant), and the question we face is termination under section 507(a)(1).

[16] See the statements in the 1965 Louisiana Court of Appeal opinion that "the heirs have a right only to submit an alternative plan as to how the general purpose of the Trust can be better accomplished. * * * [I]f the heirs should prevail, * * * the remaining assets of the Trust, * * * would escheat to the collateral heirs which the testatrix never intended." (Bonner v. Board of Trustees, 181 S.2d 255, 258 (La. App. 1965)).